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No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

REPUBLIC NATIONAL LIFE INSURANCE COMPANY

and

AMERICAN LIFE PENSION HEALTH ASSOCIATES, INC.,
Petitioners,

v.

CALVIN C. SPARKS AND SUZANNE SPARKS,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ARIZONA

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QUESTION PRESENTED

Whether the Arizona Supreme Court denied the Petitioners due process of law when it

1. Affirmed the trial court's *sua sponte* grant of a directed verdict for the plaintiffs at the close of the plaintiffs' case, thus denying the defendants any opportunity to be heard on the question of their liability to the plaintiffs;

2. (a) Affirmed a jury verdict totalling more than $4.5 million on the basis of a charge to the jury that the Court simultaneously held to be erroneous;

   (b) Refused to disturb its holding that the two petitioners (defendants below) were jointly and severally liable to pay punitive damages assessed by the jury against all three defendants even though the Court also held that the jury had been improperly instructed because the third defendant had committed no wrong and must be dismissed from the litigation;

3. Affirmed the trial court's assessment of attorney's fees against petitioners on the basis of documentary evidence that petitioners were not permitted to see.

LIST OF PARTIES

Pursuant to Rule 21.1(b), Rules of the Supreme Court, counsel for Petitioners certify that the following is a complete list of all parties to the proceedings below:

1. All parties listed in the caption of this petition.

2. Planned Security Trust.

A listing naming the parent company and affiliates of Petitioner Republic National Life Insurance Company is reproduced in the Appendix (App. 43a-44a). Republic has no subsidiaries that are not wholly owned, and Petitioner American Life Pension Health Associates, Inc., has no parent, subsidiaries, or affiliates.

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v.

CALVIN C. SPARKS AND SUZANNE SPARKS,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ARIZONA

Petitioners, Republic National Life Insurance Company and American Life Pension Health Associates, Inc., pray that a Writ of Certiorari issue to review the judgment of the Supreme Court of the State of Arizona entered in this matter on June 10, 1982 (Opinion) and July 15, 1982 (Supplemental Opinion).

OPINION BELOW

The Opinion and the Supplemental Opinion of the Supreme Court of the State of Arizona, and the judgment of the Superior Court of the State of Arizona in and for the County of Maricopa are reproduced in the Appendix.

JURISDICTION

The Arizona Supreme Court entered its Opinion on June 10, 1982. (App. 1a-31a). The Arizona Supreme Court entered its Supplemental Opinion and denied Peti-

tioners' timely Motion for Rehearing on July 15, 1982. (App. 32a-33a). On July 16, 1982, the Supreme Court issued its Mandate to the Superior Court for action consistent with the Court's Opinion and Supplemental Opinion. (App. 37a). A judgment pursuant to the July 16 Mandate was entered by the Superior Court on July 21, 1982. (App. 36a-38a). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(3).

CONSTITUTIONAL PROVISION AT ISSUE

Amendment XIV of the Constitution of the United States of America:

> SECTION 1. All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

STATEMENT OF THE CASE

Petitioners, Republic National Life Insurance Company and American Life Pension Health Associates, Inc. (ALPHA), have been held jointly and severally liable for total damages of $4.5 million arising from the termination of Respondents', Calvin and Suzanne Sparks, insurance benefits for Respondents' nonpayment of the premiums required to keep the policy in force.

Background

In August 1976, Respondents Calvin and Suzanne Sparks purchased an air conditioning business in Mesa, Arizona known as Sun Valley Sales & Air Conditioning, Inc. On April 1, 1977, Calvin Sparks met with his in-

dependent broker, Robert Bowden, to secure a group health insurance policy for his family and his company's employees. Bowden recommended and Sparks purchased a policy underwritten by Petitioner Republic, administered by Petitioner ALPHA, and funded through Planned Security Trust (PST). Calvin Sparks sent his first premium payment on April 1, 1977, along with his application. ALPHA approved the issuance of insurance to Sun Valley Sales, and mailed the certificates of insurance to the broker, who subsequently delivered them to Sun Valley Sales.

On May 1, 1977, the Sparkses' family airplane, piloted by Calvin Sparks, crashed, resulting in serious injury to Calvin Sparks and Kevin Sparks, the Sparkses' five-year-old son. Suzanne Sparks and another child received minor injuries. Respondents subsequently filed an insurance claim pursuant to their coverage with Republic, ALPHA, and PST.

Due to the severity of his injuries, Calvin Sparks was unable to manage the air conditioning business. Sun Valley Sales went bankrupt in December 1977. Insurance premiums were paid through October 1977, and Petitioners paid claims for charges incurred through November 30, 1977.[1] At that time, Petitioners had honored claims totalling more than $83,000 under the policy for the treatment of all four of the Sparks family injured in the accident.

In March 1978, Petitioners advised Suzanne Sparks that, under provisions of the policy, insurance coverage had terminated for nonpayment of premiums, and that

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[1] Although not relevant to its holding, the Arizona Supreme Court erred in stating that premiums had been paid through December 16, 1977. That was the day on which the business closed, but premium payments had been made only through October and claims were paid through November pursuant to a grace period provision in the policy.

Petitioners therefore would not pay further benefits to Calvin or Kevin Sparks for expenses and treatment incurred after December 1, 1977.

Proceedings in the Trial Court

On January 10, 1980, Respondents brought an action alleging breach of contract and tort claims against Republic, ALPHA, and PST. Respondents sought past and future unpaid insurance benefits under the policy, and general and punitive damages arising from the defendants' alleged tortious termination of insurance benefits. An eight-day jury trial began on August 26, 1980.

At the close of *plaintiffs'* case, the court, *on its own motion*, directed a verdict for the plaintiffs on the contract issues, ruling that all contract rights were fixed by terms of a sales brochure and not by the insurance contract, and that defendants had breached their contract by refusing to continue the payment of benefits once premium payments had ceased. This occurred before any defendant had made an opening statement or called a single witness. Thus, the basic liability issue in the case was decided adversely to the defendants without their having the opportunity to be heard.[2] The trial continued on other issues.

In delivering its charge to the jury, the court read an instruction on tort damages relating to the bad-faith claims which measured the reasonableness of the insurer's claim denial on the basis of "whether the conduct of the

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[2] Defendants challenged this irregularity in their Motion for Judgment Notwithstanding the Verdict and Motion for New Trial (Memorandum of Points and Authorities in Support of Defendants' Motion for Judgment Notwithstanding the Verdict and Motion for New Trial at 1-2). The motions were denied by the trial court. The point was preserved on appeal in the Arizona Supreme Court (Appellants' Opening Brief at 11-12; 16-18), and mentioned again in the Motion for Rehearing in that court (Appellants' Memorandum in Support of Motion for Rehearing at 2).

insurer was *justified* and reasonable under the circumstances . . . ." (emphasis added). The inadequacy of the jury instruction was challenged in Defendants' Motion for Judgment Notwithstanding the Verdict and Motion for New Trial (Defendants' Memorandum of Points and Authorities at 44-46). The motions were denied by the trial court. The challenge was preserved on appeal in the Arizona Supreme Court (Appellants' Opening Brief at 27-32), and renewed in the Motion for Rehearing (Appellants' Memorandum at 1, 11-15, 23).

At the conclusion of the trial, the jury returned a verdict against all three defendants in the amount of $1,551,000 in compensatory damages and $3,000,000 in punitive damages.

On September 22, 1980, a special hearing for the award of attorney's fees was conducted to the court without a jury. At the request of plaintiffs and over defendants' protest, the court entered a protective order denying defendants the opportunity to inspect the fee agreement between plaintiffs and their counsel. The court ruled that it would review the agreement *in camera* and that this would assure that the final award did not exceed the statutory limit prescribed under Arizona law. The court then assessed attorney's fees against defendants in the sum of $80,000. Defendants challenged this ruling in their Motion for Judgment Notwithstanding the Verdict and Motion for New Trial (Defendants' Memorandum of Points and Authorities at 74, 76), which were denied by the trial court. The point was preserved on appeal in the Arizona Supreme Court (Appellants' Opening Brief at 14-15, 48-49, 52-55).

Judgment was entered on September 23, 1980 (App. 34a-35a), and defendants filed a timely notice of appeal from the judgment of the Superior Court in the Court of Appeals of the State of Arizona.

The *Noble* Decision

On February 17, 1981, while Petitioners' appeal was pending, the Arizona Supreme Court rendered its opinion in *Noble v. National American Life Insurance Company*, 624 P.2d 866 (Ariz. 1981), which created the previously nonexistent (in Arizona) tort of bad-faith refusal to pay an insurance claim, and clearly set forth the elements of the tort. *Id.* at 868.

Under *Noble*, a jury instruction that properly embodies the elements of the tort must include the following: (1) plaintiff must establish the absence of a reasonable basis for denying policy benefits; (2) plaintiff must *also* show that the insurer knew that there was no reasonable basis for the denial or acted in reckless disregard as to whether there was a lack of reasonable basis; (3) the jury must determine the absence of a reasonable basis for denying the claim in light of whether a "reasonable insurer under the circumstances" would have denied or delayed payment; and (4) an insurance company that challenges the claims of its insured which are "fairly debatable" is not acting in bad faith. *See id.*

Proceedings In The Appellate Courts

Defendants raised the following arguments on appeal:

1. The trial court committed reversible error by its prematurely and *sua sponte* directing a verdict against defendants on the contract issues before defendants had begun to present their defense.

2. The trial court's instruction to the jury on the tort of bad faith was inadequate under the standard established in *Noble v. National American Life Insurance Company*, omitting several material elements of the tort as defined in *Noble* and misstating the law with regard to the elements it did include, thus unfairly prejudicing defendants.

3. The trial court erred by submitting the tort theories to the jury on the basis of joint and several liability.

4. The trial court's award of $80,000 in attorney's fees on the basis of an *in camera* review of relevant evidence which the trial court prohibited defendants from inspecting deprived defendants of Constitutional due process.

On June 10, 1982, the Supreme Court of Arizona entered its Opinion,[3] affirming the judgment as to defendants Republic and ALPHA and reversing as to defendant PST. (App. 1a). The court (1) approved without discussion the trial court's grant of a directed verdict against defendants at the close of plaintiffs' case in chief; (2) found "no error" in the jury instruction on bad-faith refusal of coverage; (3) affirmed the $3 million punitive damage award which the jury had returned against all three defendants, while simultaneously holding that the judgment against one of the defendants—PST—must be reversed; and (4) ruled that the trial court's order preventing defendants from examining evidence affecting the trial court's award of attorney's fees was consistent with Constitutional due process.

On June 25, 1982, all defendants filed a timely Motion for Rehearing, alleging errors of fact and law contained in the Court's Opinion which necessitated reversal for a new trial before a properly instructed jury. Because the Supreme Court had affirmed the judgment on the basis of a jury instruction which appeared at variance with the Court's own recently enunciated landmark ruling in *Noble*, defendants were joined by numerous *amici* in the insurance industry, who asserted that the jury instruction approved in the present case departed radically from

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[3] Defendants had noted their appeal to the Arizona Court of Appeals. The case was transferred to the Arizona Supreme Court pursuant to Rule 19, Arizona Rules of Civil Appellate Procedure.

the law announced in *Noble*, and that under the jury instructions so approved an insurer could be held liable for punitive damages even though the plaintiff had shown neither that coverage had been denied without an objectively reasonable basis nor that the insurer knew or recklessly disregarded the lack of a reasonable basis for that denial, both of which showings were required under *Noble*. 624 P.2d at 868. In addition to renewing earlier objections raised in the appeal, defendants argued that the dismissal of defendant PST required a new trial as to Petitioners Republic and ALPHA on the lump-sum punitive damage award which the jury had imposed upon all three defendants.[4]

On July 15, 1982, the Arizona Court entered its Supplemental Opinion. (App. 32a). The Supplemental Opinion in its entirety reads as follows:

> The jury instructions in this case were given before this court's decision in *Noble v. National American Life Insurance Co.*, 128 Ariz. 188, 624 P.2d 866 (1981). In the case at issue, the challenged instructions on the tort of bad faith were held not to constitute reversible error. *We*, however, *do not approve the use of those instructions* in future cases. *Our case of Noble sets out the principles which should be embodied in instructions involving the tort of bad faith.*
>
> The motions for rehearing are denied.

(emphasis added). The Court did not address any of the other issues.

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[4] Appellants' Memorandum in Support of Motion for Rehearing at 2-10. As it was clearly impossible to foresee that the dismissal of defendant PST alone would be granted, defendants thus raised this issue at the earliest possible juncture in the proceedings.

REASONS FOR GRANTING THE WRIT

The Arizona Supreme Court's decision contains four holdings, each of which denied Petitioners due process of law. Taken together, those holdings clearly merit review by this Court. That is particularly so since the jury verdict against Petitioners affirmed by the Arizona Supreme Court is the largest award of punitive damages against an insurance company for the tort of bad-faith refusal of coverage ever sustained on appeal by the highest court of a state.

I. The Arizona Supreme Court Violated Due Process By Affirming the Trial Court's Sua Sponte Grant of a Directed Verdict for Plaintiffs at the Close of Plaintiffs' Case.

At the close of the plaintiffs' case, before the defendants had had the opportunity to put on any evidence, the trial court, *sua sponte*, granted a directed verdict for the plaintiffs on the issue of the defendants' liability on the insurance contract. (App. 39a-40a). In other words, the trial court directed a verdict against Republic and ALPHA, holding that they were liable to the plaintiffs, without giving them a chance to present their case. That action was affirmed by the Arizona Supreme Court.

There is nothing more basic to due process than the opportunity to be heard in one's defense in a civil or criminal case. *Ballard v. Hunter*, 204 U.S. 241, 255 (1907). That right is an "immutable principle[] of justice which inhere[s] in the very idea of free government which no member of the Union may disregard . . . ." *Holden v. Hardy*, 169 U.S. 366, 389 (1898). *Accord, Galpin v. Page*, 85 U.S. (18 Wall.) 350, 368-69 (1873).

As could be expected, this *sua sponte* directed verdict on the liability issue gravely injured the ability of Re-

public and ALPHA to defend the lawsuit.[5] The Arizona Supreme Court affirmed on a holding that the insurance policy was defective because an "ordinary person[]" would not have understood it to provide for continued payment of claims only while premiums are kept up. (App. 11a-12a). Quoting (selectively) the testimony of the plaintiff Suzanne Sparks, the court held that the plaintiff had established that she had in fact had that defective understanding. (App. 12a). Only on this factual basis did the Supreme Court of Arizona affirm.

But Republic and ALPHA had been prevented from introducing any evidence on this factual issue—the common understanding of the insurance contract by lay people in general and the plaintiff in particular—by the *sua sponte* grant of a directed verdict by the trial court. Thus, in finding liability, the Arizona Supreme Court relied upon evidence of the plaintiffs that Republic and ALPHA, as defendants, had been denied any opportunity to rebut. Republic and ALPHA had, but could not present, evidence in their possession that showed that the plaintiff had behaved inconsistently with her testimony as to her understanding of the contract.

In sum, Republic and ALPHA were denied the opportunity to present their defense on the issue of their liability under the insurance contract. They were barred from presenting their own rebutting evidence on the very point where the Arizona Supreme Court held the plaintiff's evidence to be critical. Republic and ALPHA did not get a hearing at all on that issue. This violated due process.

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[5] Of course, after this directed verdict the trial continued on questions of bad-faith refusal of coverage and damages, but defendants did not seek leave, and no doubt would not have been permitted, to put on their evidence on the liability point already decided by the trial judge. Saunders v. Shaw, 244 U.S. 317, 319 (1917).

II. The Arizona Supreme Court Affirmed a Judgment Based on Jury Instructions It Simultaneously Held to Be Erroneous.

The Arizona Supreme Court arbitrarily ignored its duty to act as a court and to decide cases according to legal principles by affirming a jury verdict that it simultaneously held to have been based upon erroneous instructions. In *Ohio Bell Telephone Co. v. Public Utilities Comm'n*, 301 U.S. 292, 302 (1937), Justice Cardozo, speaking for the Court, found that protection from arbitrary action is the "very essence" of due process (as characterized in *Slochower v. Board of Education*, 350 U.S. 551, 559 (1956)). There could not be anything more fundamental to a judicial system than that courts decide particular cases in accordance with the legal holdings in those cases, and yet, quite clearly, the Arizona Supreme Court has twice departed from that fundamental principle.

A. The Arizona Supreme Court Affirmed a $3 Million Verdict for Bad-Faith Refusal to Pay a Claim and Simultaneously Held That the Jury Instruction on That Issue Was Improper.

The Arizona Supreme Court first recognized the tort of bad-faith refusal of an insurer to pay a valid claim in *Noble v. National American Life Insurance Co.*, 128 Ariz. 188, 624 P.2d 866 (1981). The Petitioners herein argued strenuously to the Arizona Supreme Court that the charge given in the present case was erroneous under the doctrines set by *Noble*. In its initial decision in the present case, however, the Arizona Supreme Court rejected that position and held that there was "no error in the instruction given by the trial judge." (App. 14a). A petition for rehearing was filed by Republic and ALPHA and supported by a number of *amici*, also insurance companies, asserting generally that the decision did depart radically from *Noble* in that the instruction on bad faith

in the present case did not require a showing that a refusal of coverage must be intentional or made with reckless disregard of the lack of reasonable basis for denial, and that the tort is not committed if the insurance company's action involves a challenge to a fairly debatable claim.[6]

In acting on rehearing, the Arizona Supreme Court agreed, explicitly disapproved the use of the instructions given in the present case, and insisted that "*Noble* sets out the principles which should be embodied in instructions on cases involving the tort of bad faith." (App. 33a). It could hardly be clearer that the court was holding that the present instructions did not accord with the "principles" set out in *Noble*. Nonetheless, the Court did not disturb its affirmance of the present case. This, we submit, was an arbitrary action fundamentally so at odds with principled decisionmaking as to constitute a violation of the due process of law.

In its very brief denial of rehearing, the Arizona Supreme Court offered, as an apparent explanation for its action, the statement that its earlier holding in this case had not been that the charge was valid, but merely that it "[did] not . . . constitute *reversible* error." (App. 33a) (emphasis added). But that is a mischaracterization, since, as quoted above, the court had originally held: "We find *no error* in the instruction given by the trial judge." (App. 14a) (emphasis added).

In sum, the main opinion holds that the charge accorded with *Noble* and, by implication, could properly be given again. Indeed, that is precisely the basis for Re-

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[6] Brief in Support of Appellants' Motion for Rehearing by Amici Curiae American Council of Life Insurance and Health Insurance Association of America at 2-4; Memorandum of Amici Curiae Connecticut General Life Insurance Company *et al.* in Support of Motion for Rehearing at 3-5; Brief of Amici Curiae American Title Insurance Company *et al.* at 1-5.

public and ALPHA's decision to seek rehearing and was the stated basis for the support for rehearing urged by other insurance companies as *amici curiae*. It is equally clear that the denial of rehearing holds that the charge did not accord with *Noble*, and that any other judgment based upon that instruction would be reversed on appeal. For example, if the present case had to be retried for some reason, there is no question that the same charge could not be used. The denial of rehearing by the Arizona Supreme Court thus clearly affirms a judgment based upon jury instructions that it simultaneously holds were erroneous.[7] The Arizona Supreme Court's action denies due process of law because it recognizes that it is not based upon the law.

B. The Judgment Requires Petitioners to Pay Punitive Damages Assessed Against Another Defendant That the Arizona Supreme Court Held Should Not Be Liable.

Punitive damages of three million dollars were assessed by the jury, jointly and severally, against three defendants: Republic, ALPHA, and PST. The instructions required the jury to take the defendants' size and resources into account in assessing the amount of punitive dam-

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[7] The denial of rehearing also points out that the jury instructions were given before *Noble* was decided (App. 33a), but no suggestion can be drawn from this that the Arizona Supreme Court here merely decided not to make *Noble* retrospective. Arizona follows a rule on retrospectivity that is at least as strict as the federal rule, and under neither rule could *Noble* be denied retrospective application. Peagler v. Phoenix Newspapers, Inc., 560 P.2d 1216, 1220-21 (Ariz. 1977); Chevron Chemical Co. v. Superior Court, 641 P.2d 1275, 1279 (Ariz. 1982); Gulf Offshore Co. v. Mobil Oil Corp., 453 U.S. 473, 486 n.16 (1981). Even more fundamentally, the jury charge in the present case did not reflect the application of law as it existed in Arizona before *Noble*. There was no cause of action for bad-faith refusal of coverage before *Noble*, and thus the jury charge in the present case was nothing more than an inadequate attempt to predict the law on this point.

ages.[8] The jury apparently did so, awarding a lump three-million-dollar sum against all three defendants.

On appeal, however, the Arizona Supreme Court held that the trial court had erred in holding one of the three defendants, PST, to be liable. (App. 18a). The court also held that the jury instruction "regarding joint and several liability in tort as to PST *was improper* . . . ." (App. 18a) (emphasis added).

Nonetheless, the court refused to disturb the jury verdict of punitive damages itself even though it held that the jury had been erroneously instructed. Because the court refused to disturb the judgment, the remaining two defendants, Petitioners here, have had to pay damages assessed by the jury in an amount sufficient to punish *three* defendants when the Arizona Supreme Court held that one of those defendants should not have been subject to punitive damages. Thus, part of the jury verdict on punitive damages—the amount the jury assessed to punish PST under the erroneous instructions—was necessarily excessive and erroneous. Had the jury been properly instructed, without PST as a defendant, it is all but certain that it would have returned a substantially lower amount as punitive damages.[9] *Washington Gas Light Co. v. Lansden*, 172 U.S. 534, 555-56 (1899).[10]

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[8] The trial court instructed the jury that it could award punitive damages "in an amount which you feel will adequately punish defendants for *their* conduct . . . ." (App. 41a-42a) (emphasis added). The trial court further instructed the jury that "in determining the amount of punitive damages to be awarded, you may consider the financial worth or wealth of *the defendants*." (App. 42a) (emphasis added).

[9] With the jury's award of three million dollars to punish three defendants, the assumption is inescapable that the jury roughly assessed one million dollars per defendant.

[10] In *Washington Gas Light*, this Court held, in very similar circumstances, that the judgment must be reversed and the cause retried, because "the original verdict was against the three defend-

Republic and ALPHA have been forced to pay the entire judgment in this case. Just as clearly, part of that judgment constitutes punitive damages assessed by the jury to punish PST, even though the Arizona Supreme Court held that PST could not be held liable. Thus, Republic and ALPHA have had to pay damages that the Arizona Supreme Court has held should never have been assessed—damages to punish an act that, the court held, did not occur. It is certainly a violation of due process for Republic and ALPHA to be required to pay damages attributable to an action which the court holds at the same time is not wrongful.

III. The Arizona Supreme Court Denied Petitioners Due Process of Law By Approving the Trial Court's Reliance Upon Documentary Evidence That Petitioners Were Forbidden to See Which Affected the Trial Court's Award of $80,000 in Attorney's Fees.

The trial court held a separate hearing on the award of attorney's fees. To assure that the fees awarded were within the statutory limitation prescribed by Arizona statute,[11] Republic and ALPHA sought discovery of the

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ants . . . and it is possible, if not probable, that if a verdict had been rendered against the individual defendant alone, it would have been for a materially less amount." 172 U.S. at 555. The present case is *a fortiori*, since the Court's doubt as to the result on retrial was due to a question as to whether the jury was assessing punitive (or merely compensatory) damages. *Id.* at 554-55. Here there is no doubt.

[11] A.R.S. 12-341.01 provides in applicable part:

> A. In any contested action arising out of a contract, express or implied, the court may award the successful party reasonable attorney's fees. This section shall in no manner be construed as altering, prohibiting, or restricting present or future contracts or statutes that may provide for attorney's fees.
>
> B. The award of reasonable attorney's fees awarded pursuant to subsection A should be made to mitigate the burden of the

fee agreement between plaintiffs and their counsel. The trial court ruled that it would review the fee agreement *in camera* before making its award, but refused to permit Republic and ALPHA to inspect the agreement.

The Arizona Supreme Court approved the trial court's *ex parte* receipt of evidence with the *ipse dixit* that "[t]he hearing and the judge's personal inspection of the fee agreement adequately safeguarded defendants' due-process rights." (App. 28a).

Such a procedure is a flat and incontestable violation of due process. The due process right to a hearing is "nullif[ied]" without an opportunity to see the evidence: "[T]here is no hearing when the party does not know what evidence is offered or considered and is not given an opportunity to test, explain, or refute." *Interstate Commerce Commission v. Louisville & Nashville R.R. Co.*, 227 U.S. 88, 93 (1913). This Court held in *Louisville & Nashville* that to satisfy due process:

> [a]ll parties must be fully apprised of the evidence submitted or to be considered, and must be given opportunity to cross-examine witnesses, to inspect documents and to offer evidence in explanation or rebuttal. In no other way can a party maintain its rights or make its defense.

Id. at 93. *Accord, Ohio Bell Telephone Co. v. Public Utilities Comm'n*, 301 U.S. 292 (1937).

There can be no question that the Arizona Supreme Court violated due process in affirming a judgment based upon documentary evidence that Republic and ALPHA were not allowed to see.

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expense of litigation to establish a just claim or a just defense. It need not equal or relate to the attorney's fees actually paid or contracted, but such award may not exceed the amount paid or agreed to be paid.

CONCLUSION

In its opinion, the Arizona Supreme Court made several determinations which, taken singly or together, deprived Petitioners of Constitutional due process as guaranteed by the Fourteenth Amendment and as interpreted in decisions of this Court.

For these reasons, a Writ of Certiorari should be granted.

Respectfully submitted,

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Date: October 13, 1982

IN THE SUPREME COURT
OF THE STATE OF ARIZONA
En Banc

No. 15488
CALVIN C. SPARKS and SUZANNE SPARKS,
husband and wife,
Appellees,

v.

REPUBLIC NATIONAL LIFE INSURANCE COMPANY, a Texas corporation; AMERICAN LIFE PENSION HEALTH ASSOCIATES CORPORATION, an Iowa corporation, dba ALPHA CORPORATION, PLANNED SECURITY TRUST, a trust,
Appellants.

[Filed Jun. 10, 1982]

Appeal from the Superior Court of Maricopa County
The Honorable Philip W. Marquardt, Judge

(Cause No. C-402143)

AFFIRMED IN PART
REVERSED IN PART

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Attorneys for Appellees

HAYS, Justice

This is an appeal by defendants Republic National Life Insurance Company (Republic), American Life Pension Health Associates Corporation (ALPHA), and Planned Security Trust (PST), from a verdict and judgment of the Superior Court of Maricopa County. We have jurisdiction pursuant to 17A A.R.S. Rules of Civil Appellate Procedure, rule 19(e).

In August of 1976, plaintiffs, Calvin and Suzanne Sparks, purchased an air conditioning business in Mesa, Arizona, known as Sun Valley Sales & Air Conditioning, Inc. The business was managed entirely by Calvin Sparks. In April of 1977, Calvin met with Robert Bowden, an insurance agent, in order to secure a health insurance policy for his family and the air conditioning company's employees. Bowden recommended a policy underwritten by Republic, administered by ALPHA and funded through PST. During this meeting, Bowden showed Sparks a sales brochure written by ALPHA and approved by Republic. The cover of the brochure contained a headline, "Planned Security Trust", "$250,000 Comprehensive Major Medical". The remainder of the brochure explained the general provisions of the policy such as eligibility requirements, special major medical features, exclusion of coverage for preexisting conditions and occurrences which would terminate insurance. The termination of insurance section stated that insurance would be terminated for, among other things, nonpayment of premiums. The brochure also contained a prominently displayed box containing capital letters which informed the reader that a more complete description of benefits would be found in the certificate of insurance issued to insured employees. It also informed the reader that all benefits were subject to the master group policy held by PST.

Consistent with the brochure, Bowden explained that under "Plan I" of the policy, in the event of illness or

accident, an employee would pay a $100 deductible and, thereafter, full benefits of up to $250,000 per person would be paid by the insurance company for any additional covered medical expenses. The brochure was the only written document which Calvin Sparks saw before applying for the insurance. Calvin sent his first premium payment on April 1, 1977, along with his application.

Exactly one month after purchasing the insurance, Calvin, Suzanne and their three children flew to Safford to visit relatives. On the return flight to Mesa, the small passenger plane in which they were flying crashed. Calvin sustained permanent brain damage. Kevin, the Sparks' five-year-old son, was rendered a paraplegic, as well as suffering a broken jaw and several facial lacerations. Suzanne and another child received minor injuries.

Because of his injuries and resulting mental impairment, Calvin was unable to manage the air conditioning business. As a result, Sun Valley Sales went bankrupt in December of 1977. Insurance premiums were paid until December 16, 1977, when the business was closed. At that time, the defendants had paid less than $84,000 under the policy for the treatment of all four of the Sparks family injured in the accident.

In January of 1978, Suzanne received a letter from the defendants returning a premium check for underpayment. In February 1978, Suzanne received another letter from ALPHA advising her of new premium charges for the policy and thanking her for doing business with the defendants. Finally, in March 1978, defendants advised Suzanne that they would not pay any further benefits to Calvin or Kevin for expenses or treatment incurred after December 1, 1977. Defendants explained that under the provisions of the policy, when insurance coverage was terminated, defendants were no longer obligated to pay for any medical expenses for an injury or illness which occurred while the insurance was in effect.

After being informed that defendants would no longer pay any medical benefits, Suzanne reviewed the insurance policy which had been provided to her by Bowden *after* the accident. After reading the policy, she was unable to understand whether the policy language limited coverage as asserted by the defendants, so she referred to the sales brochure. Having read the brochure, it was her understanding that "[w]hen the business closed the insurance would no longer cover it, if we had another accident the next day. But I expected coverage for injuries incurred in the accident while the policy was in force."

Because of defendant's refusal to pay further medical benefits, Kevin was forced to forgo needed muscle release surgery on his left thigh. Although the surgery was later performed at the Arizona Children's Hospital in March 1980, the delay resulted in deformity to Kevin's left leg, leaving the leg two inches shorter than the right. Kevin was also unable to obtain braces or crutches due to defendants' refusal to pay benefits. A recent examination of Kevin revealed that his spine had become badly curved due to his confinement in a wheelchair. The Sparkses also were forced to forgo additional medical and psychological care for Calvin. Expert medical testimony established that both Kevin and Calvin would need continuing treatment throughout their lives.

On January 10, 1980, the Sparkses brought an action alleging breach of contract and various tort claims against the defendants. The plaintiffs sought past and future unpaid insurance benefits under the policy and general and punitive damages arising from defendants' alleged tortious termination of the insurance benefits. At the conclusion of an eight-day jury trial, a verdict was returned against all defendants in the amount of $1,551,000 in compensatory damages and $3,000,000 in punitive damages. The court also awarded attorney's fees to the plaintiffs in the amount of $80,000.

Defendants raise the following arguments on appeal:

1. The trial court erred by ruling that all contract rights were fixed by the terms of the sales brochure.
2. The trial court erred in instructing the jury on the tort of bad faith.
3. The trial court erred by submitting the tort theories to the jury on the basis of joint and several liability.
4. The trial court erred when it instructed the jury that defendants could be found liable in tort for violation of A.R.S. § 20-443 of the Arizona Insurance Code.
5. The trial court erred when it instructed the jury that Robert Bowden was an agent of the defendants.
6. The trial court's award of $80,000 in attorney's fees violates A.R.S. § 12-341.01 and denied defendants due process of law.

THE INSURANCE CONTRACT

Defendants' position throughout the litigation has been that the master policy provided that the payment of medical expense benefits would cease upon termination of the insurance coverage. Defendants argue that the trial court committed reversible error by ruling that all contract rights were fixed by the terms of the sales brochure and not by the insurance contract. Plaintiffs respond by asserting that the trial court ruled that the defendants were contractually liable even if the master policy were considered alone or construed in conjunction with the brochure.

The interpretation of an insurance contract is a question of law to be determined by the Court independent of

the findings of the trial court. State Farm Fire & Casualty Co. v. Rossini, 107 Ariz. 561, 490 P.2d 567 (1971). On appeal, we will sustain the trial court's ruling on any theory supported by the evidence, even though the trial court's reasoning may differ from our own. Minderman v. Perry, 103 Ariz. 91, 437 P.2d 407 (1968). The trial court instructed the jury that defendants had breached their contract with plaintiffs and did not elaborate on the reasoning behind this determination. After examining the provisions of the policy, we agree with the trial court's conclusion.

Provisions of insurance policies are to be construed in a manner according to their plain and ordinary meaning. Parks v. American Casualty Co. of Reading, 117 Ariz. 339, 572 P.2d 801 (1977). Where the language employed is unclear and can be reasonably construed in more than one sense, an ambiguity is said to exist and such ambiguity will be construed against the insurer. Ranger Insurance Co. v. Lamppa, 115 Ariz. 124, 563 P.2d 923 (App. 1977). In determining whether an ambiguity exists in a policy, the language should be examined from the viewpoint of one not trained in law or in the insurance business. State Farm Mutual Auto Insurance Co. v. O'Brien, 24 Ariz. App. 18, 535 P.2d 46 (1975).

Defendants direct us to several provisions of the policy that are said to clearly and unequivocally terminate the defendants' obligation to pay insurance benefits to the plaintiffs upon nonpayment of premiums. Section 1 entitled "POLICY TERM" states: "The policy continues from its effective date as long as the premium is paid as herein agreed . . ." Section 5 entitled "PERSON'S TERMINATIONS" states, in pertinent part, that the "insurance of the Insured Person shall terminate" either when the "policy is terminated" or on "the premium due date when the policyholder fails to pay the required premium," whichever is first. Section 23 entitled "MAJOR MEDICAL BENEFITS" states:

"When as the result of Accidental bodily injury or sickness, an Insured Person incurs Covered Expenses shown herein while this insurance is in force as to such person, the Company will pay the applicable percentage, shown in the Schedule of Benefits hereof, of such expenses incurred in excess of the Deductible Amount, not to exceed the Maximum Amount."

Also contained in Section 23 is a heading labeled "EXTENSION OF MAJOR MEDICAL BENEFITS PROVISIONS" which provides as follows:

"If accidental bodily injury is sustained or sickness commences while these Major Medical Benefits are in force as to the Insured Person, Covered Expenses otherwise payable under the policy will be paid for any such expenses incurred as the result of such injury or sickness after the termination of insurance of an Insured Person if from the date of such termination of insurance to the date such Expenses are incurred the Insured Person is wholly and continuously disabled by reason of such accidental bodily injury or sickness. Such benefits shall be payable only during the continuance of such disability but not beyond the earliest of the following dates: (A) three months from the date the insurance of the Insured Person terminated, (B) on the date the Policy is terminated, (C) for persons whose insurance became effective after the effective date of the Master Policy, on the last day of a period equal to the time the Insured Person was insured under these Major Medical Benefits, (D) on the date the Insured Person becomes covered or insured under any other group policy (whether issued by the Company or any other Insurer) or any group basis service or prepayment plan, (E) the reinstatement of Maximum Amount shall not be applicable in the case of any Insured Persons entitled to benefits in accordance with this provision."

If an insurer desires to limit its liability under a policy, it should employ language which clearly and distinctly communicates to the insured the nature of the limitation. Transamerica Insurance Co. v. McKee, 27 Ariz. App. 158, 551 P.2d 1324 (1976). Our reading of the foregoing provisions leads us to conclude that the policy is ambiguous and fails to communicate the nature of the limitations urged by defendants.

Initially, it must be pointed out that the sections of the policy which an insured would normally look to in order to ascertain what the policy does *not* cover are silent on the limitations argued by defendants. Under Section 8, "Definitions and Exceptions", the policy states that it does not cover expenses incurred for such things as war, self-inflicted injury, or injury or sickness covered by workmen's compensation. There is no mention that benefits will be terminated when the insurance is terminated. Under Section 23 subheading entitled "LIMITATIONS" the policy states that benefits shall not be payable for cosmetic surgery or treatment for alcoholism or drug addiction. No mention is made of the fact that benefits for injuries incurred while the insurance is in effect will not be paid after the insurance coverage is terminated.

In its statement of facts, defendants point to a provision purportedly contained in the insurance policy which would arguably put an insured on notice that payment of benefits would continue only as long as the insurance was in force. That provision states:

> "Notwithstanding any statements to the contrary in the benefits provision of this policy, no accident and sickness benefit payment shall be made for expenses incurred after the date the policy is terminated."

This particular provision, however, was not in the policy ultimately issued to plaintiffs. Without such a provision,

the policy language contained in Sections 1, 5 and 23 fall far short of clearly and distinctly communicating to the insured the nature of the limitation asserted by defendants.

Sections 1 and 5 do nothing to support defendants' argument. They indicate the obvious: if premiums are not paid, the insurance terminates. This can hardly be construed to communicate effectively to the insured that the termination of insurance also terminates the insurers' obligation to pay continuing benefits for an accident or illness which occurred while the insurance was in force.

The first portion of Section 23, "MAJOR MEDICAL BENEFITS" comes closest to informing the insured that benefits are not payable after termination. However, while an individual clause of an insurance policy, standing alone, might be determined to have no ambiguity, "the policy must be read as a whole in order to give a reasonable and harmonious meaning and effect to all its provisions." Federal Insurance Co. v. P.A.T. Homes, Inc., 113 Ariz. 136, 139, 547 P.2d 1050, 1053 (1976). Moreover, the facts of the present case are uncommon in that the only document which the insured had an opportunity to examine before the loss was the sales brochure, which, in our opinion, also fails to communicate the limitation of coverage urged by defendants. In such a situation, the words of the advertising brochure issued by the insurer should be considered as they affect the ordinary person as to the meaning of the words in the policy itself. *See* Craver v. Union Fidelity Life Insurance Co., 35 Ohio Misc. 15, 298 N.E.2d 918, *affirmed*, 37 Ohio App. 2d 100, 307 N.E.2d 265 (1973); Weinberg v. Insurance Co. of North America, 88 Misc. 2d 82, 388 N.Y.S.2d 69 (1976); Morris v. Traveler's Insurance Co., 546 S.W.2d 477 (Mo. App. 1976); *see also* 13A Appelman, *Insurance Law & Practice*, § 7534 at

130.[1] When the first portion of Section 23 is read in conjunction with the other provisions of the policy and the sales brochure which both promise maximum benefits of $250,000, the language could also be read to provide that the company will pay expenses, not in excess of the maximum amount, if the injury or sickness occurred while the insurance was in force and the expenses incurred resulted from the injury or sickness.

Finally, that portion of Section 23 entitled "EXTENSION OF MAJOR MEDICAL BENEFITS PROVISIONS" also fails to support defendants' position. The first sentence of the paragraph seemingly provides for continuing payment of benefits after termination of insurance if the insured is "wholly and continuously disabled," but in the next sentence, provides that benefits will be terminated if the policy is terminated. Not only is this paragraph contradictory, and the supposed limitation hidden under a title which is misleading, but it illustrates that the policy provides no protection to a disabled insured.[2] None of the foregoing provisions

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[1] Defendants maintain that we have already held that the provisions of a group insurance policy control over the information contained within a sales brochure, citing Sahlin v. American Casualty Co. of Reading, 103 Ariz. 57, 436 P.2d 606 (1968). Defendants have misread *Sahlin*. In that case, we held that the plaintiff had failed to make a case of estoppel against the insurer where the insured could not be considered "excusably ignorant" of the terms of the master policy which were inconsistent with alleged ambiguities contained within the sales brochure. In *Sahlin*, the insured had ample notice of the *unambiguous* provisions of the policy before his death, unlike the present case, in which Calvin Sparks never saw the policy before his accident. Thus, although we believe that plaintiffs in the present case could successfully assert estoppel against defendants under *Sahlin*, we need not rely on this equitable principle in view of our finding that the policy is ambiguous and must be construed against defendants.

[2] When Section 23 is read in conjunction with other portions of the policy, it is obvious that a person suffering a disabling injury or illness could never collect the maximum benefits promised *under*

clearly sets out the nature of the limitation on coverage. At most, the provisions which defendants rely upon create a doubt regarding the coverage or terms of the contract, and this doubt must be resolved against the insurer. State Farm Mutual Auto Insurance v. Paynter, 122 Ariz. 198, 204, 593 P.2d 948, 954 (App. 1979).

Defendants respond, however, that medical expense insurance policies are subject to "recognized differences in their interpretation born out of their use and commercial customs." They argue that courts recognize that medical expense insurance provides a right of reimbursement for expenses incurred during the term of the policy, and not otherwise. This argument might be persuasive if the controversy before us were between two insurers. However, we are not concerned with what the "commercial customs" are in the insurance industry, but rather, what the ordinary person's understanding of the policy would be. As noted above, in construing the meaning of an insurance policy, the language used should be viewed from the standpoint of the average layman who is untrained in the law or insurance. Federal Insurance Co. v. P.A.T. Homes, Inc., 113 Ariz. 136, 547 P.2d 1050 (1976); Thompson v. Government Employees Insurance Co., 122 Ariz. 18, 592 P.2d 1284 (App. 1979). An ordinary person reading the policy would understand the coverage to operate as it does under a typical automobile or homeowner's policy; *i.e.*, if there is a covered loss on day one, and the insurance policy terminates on day two,

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defendants' interpretation of the policy. For example, Section 5, subparagraph (3)(B), provides that insurance shall terminate if the insured "ceases to be engaged regularly at least 30 hours weekly." The paragraph further provides that if the cessation of work is due to a disability which prevents the insured from working, the insurance shall remain in effect, but not in excess of a period of six months. Under these circumstances, it is difficult to imagine an injury or illness which would result in medical expenses totaling in excess of a quarter of a million dollars in six months or less.

the insurance company is obligated to pay the claim to policy limits, irrespective of the termination date of the insurance. Only claims which first arise after termination are not covered. This was the understanding of Suzanne Sparks after she had read defendant's policy. As she stated at trial, "Sure I was aware [of the policy provisions]. When the business closed the insurance would no longer cover it, if we had another accident the next day. But I expected coverage for injuries incurred in the accident while the policy was in force."

It was not error for the trial court to direct a verdict in favor of plaintiffs on the contract issue.

BAD FAITH

Defendants also raise the argument that the form of the bad-faith instruction unfairly prejudiced them. Our examination of the instructions reveals that this argument does not really concern the bad-faith instructions, but is more in the nature of a general objection as to the sequence in which the instructions were read to the jury. We deal with this argument first.

After instructing the jury that the court had already determined that defendants had breached their insurance contract with the plaintiffs, the trial judge inadvertently read an instruction on tort damages relating to the bad-faith claims, instead of an instruction on contract damages. The court read its instructions to the jury in the presence of counsel who had an opportunity to follow along with their own versions of the instructions. After reading the instructions to the jury, the court specifically asked whether counsel had "corrections or additions" to the instructions as given. Counsel for defendants replied categorically that they had none. Because defendants failed to object to the sequence of the reading of the instructions, they have waived any error on appeal. Orlando v. Northcutt, 103 Ariz. 298, 441 P.2d 58 (1968); City of Scottsdale v. Kokaska, 17 Ariz. App. 120, 495

P.2d 1327 (1972); 16 A.R.S. Rules of Civil Procedure, rule 51(a).

1. *Correctness of bad-faith instruction under Noble.*

The jury was instructed on bad faith as follows:

> Under Arizona law, every insurance contract contains an implied promise of good faith and fair dealing which the insurance company owes to its insured. This promise imposes an obligation on the insurance company to deal fairly in handling a claim made by its insured under the policy and to not unreasonably withhold payment of promised benefits to its insured.
>
> Reasonableness is to be determined on the basis of whether the conduct of the insurer was justified and reasonable under the circumstances found herein.

In Noble v. National American Life Insurance Co., 128 Ariz. 188, 624 P.2d 866 (1981), we recognized that an insurer's bad-faith refusal to pay a valid claim submitted by its insured under a policy of insurance gives rise to a cause of action in tort. In defining the elements of the tort, we quoted with approval from the Wisconsin case of Anderson v. Continental Insurance Co., 85 Wis. 2d 675, 271 N.W.2d 368 (1978), which focused the inquiry of whether an insurer had acted in bad faith by asking, "would a reasonable insurer under the circumstances have denied or delayed payment of the claim under the facts and circumstances." 85 Wis. 2d at ——, 271 N.W. 2d at 377. We concluded by stating:

> "Under the *Anderson* standard an insurance company may still challenge claims which are fairly debatable. The tort of bad faith arises when the insurance company intentionally denies, fails to process or pay a claim *without a reasonable basis for such action.*"

128 Ariz. at 190, 624 P.2d at 868 (emphasis added).

Defendants contend that under *Noble*, the trial court's instruction on bad faith was deficient in three respects: 1) the instruction did not recognize that refusal to pay an insurance claim may be excused if there is justification for the refusal, *i.e.*, that the obligation to pay was "fairly debatable"; 2) the instruction did not define the tort of bad faith as an intentional one; and 3) the instruction did not require proof that the denial to pay was unreasonable as measured by the standard of a "reasonable insurer."

We find no error in the instruction given by the trial judge. Although the instruction did not expressly state that an insurer may challenge claims which are fairly debatable, the absence of such a statement does not render the instruction fatally deficient. The portion of the instruction which measured reasonableness by determining "whether the conduct of the insured was justified and reasonable under the circumstances" is adequate in informing the jury, albeit implicitly, that the insurer may challenge a claim without acting in bad faith.

Second, defendants' assertion that the trial court erred by failing to include an intent element in the bad-faith instruction is incorrect. A jury need not be specifically instructed that an intent element is necessary to establish the tort of bad faith. We emphasized in *Noble*, that the inquiry into whether an insurer has acted in bad faith towards its insured is a question of reasonableness under the circumstances of the case. Any action taken by the insurer on a claim submitted by an insured will necessarily be an intentional act. Whether the action amounts to bad faith depends upon whether the insurer failed to honor a claim without a reasonable basis for doing so. These considerations were covered by the trial court's instruction. Further, defendants did not request an instruction which contained any intent element. Instead, they requested an instruction that bad-faith recov-

ery depends upon "so unreasonably . . . . dealing with another party to the contract that no reasonable person could believe that the conduct was justified by any right provided under the contract." As can be seen, defendants' requested instruction also failed to define the tort of bad faith as an intentional one. The objection raised now is born out of hindsight and cannot be raised for the first time on appeal. 16 A.R.S. Rules of Civil Procedure, rule 51(a); Hurvitz v. Coburn, 117 Ariz. 300, 572 P.2d 128 (App. 1977).

Finally, defendants maintain the jury should have been instructed that in order to find defendants guilty of bad faith, the jury must first find that defendants' denial of coverage was unreasonable under the prevailing standards of the insurance industry. This objection to the trial court's instruction was not raised below and is therefore waived on appeal. 16 A.R.S. Rules of Civil Procedure, rule 51(a); Hurvitz v. Coburn, *supra*. We also reject defendants' suggestion that the determination of whether an insurer has breached its duty of dealing with its insured in good faith necessitates proof that under prevailing standards of the insurance industry a reasonable insurer would not have denied the claim. The scope of the duty of an insurer cannot be delineated by customs of the insurance industry. *See* Silberg v. California Life Insurance Co., 113 Cal. Rptr. 711, 717, 521 P.2d 1103, 1109 (1974). What other insurance companies would have done regarding payment of benefits under the circumstances of the present case would be irrelevant in view of the likelihood that each insurance company follows varying practices regarding the payment of doubtful claims. The scope of the duty of the insurer must be measured by the facts and circumstances of each particular case. We find no error in the instruction submitted to the jury.

2. *Sufficiency of evidence in support of bad-faith instruction.*

Defendants argue that the record shows no evidence to support the tort of bad faith measured by the requirements of *Noble*. They maintain that a belief that the insurance contract had terminated for nonpayment of premiums was a privileged act of refusal and that their obligation to pay was "fairly debatable," thus precluding the giving of a bad-faith instruction.

It is reversible error to instruct the jury on a legal theory which is not supported by the evidence. *See, e.g.*, Kauffman v. Schroeder, 116 Ariz. 104, 568 P.2d 411 (1977). It is also reversible error for the trial court to refuse to instruct the jury on a legal theory which is within the issues of the case and is supported by substantial evidence. Gaston v. Hunter, 121 Ariz. 33, 588 P.2d 326 (App. 1978). We find that there was substantial evidence presented to support a prima facie case of bad faith.

We disagree with the defendants' contention that an insurer's belief that a portion of its insurance contract precludes coverage raises an absolute defense to a claim of bad faith. If the insurer's interpretation of its own contract as excluding coverage could render an insured's claim "fairly debatable," then insurers would be encouraged to write ambiguous insurance contracts, secure in the knowledge that an obscure portion of the policy would provide an absolute defense to a claim of bad faith. Although the insurer's belief that the validity of the insured's claim was fairly debatable is a defense to a charge of bad faith, such a belief is a question of fact to be determined by the jury. *See* Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Insurance Co., 279 N.W.2d 638, 643-44 (N.D. 1979).

In the present case, substantial evidence was presented entitling plaintiffs to an instruction on bad faith. De-

fendants were fully aware of the grievous nature of the Sparks' injuries and were further aware that plaintiffs would be faced with staggering medical bills upon termination of benefits. Nonetheless, defendants decided to deny any obligation to pay continuing benefits to plaintiffs based upon patently ambiguous and previously undisclosed provisions in the insurance policy. These facts, in conjunction with the trial court's determination that defendants had breached their contract with plaintiffs, were sufficient to submit the issue of bad faith to the jury.

JOINT AND SEVERAL LIABILITY OF DEFENDANTS

Defendants assert that the trial court erred by submitting the tort theories to the jury on the basis of joint and several liability.

Defendants admitted that ALPHA was a soliciting agent and servicing agent pursuant to an agreement with Republic. Republic underwrote the policy while ALPHA marketed and administered the policy. Pursuant to the agreement, ALPHA issued certificates of coverage, billed and collected premiums, and handled the investigation and payment of claims. Republic set forth guidelines for ALPHA to follow in deciding whether or not to pay any given claim. Any claims, such as the claims involved here, in excess of $5,000 were referred to Republic. Further, ALPHA prepared the sales brochure which induced Calvin Sparks to enroll in the group insurance program. This brochure was approved by Republic before distribution to prospective insureds. The evidence was uncontroverted that both Republic and ALPHA decided to deny the plaintiffs' claims.

Under these facts, we conclude that the instruction on joint and several liability was proper as to the defendants ALPHA and Republic. There must exist some com-

munity of purpose to give rise to joint tort liability. DeGraff v. Smith, 62 Ariz. 261, 157 P.2d 342 (1945). Vicarious liability for concerted action may be found to exist when the tort-feasors have entered into a joint enterprise or joint venture. *See* Prosser, *Law of Torts*, 4th Ed. § 46 (1971). A joint venture requires an agreement, a common purpose, a community of interest, and an equal right of control. West v. Soto, 85 Ariz. 255, 336 P.2d 153 (1959). Where a joint venture exists, each of the parties is the agent of the others and each is likewise a principal so that the act of one is the act of all. West v. Soto, *supra*; Conner v. El Paso Natural Gas Co., 123 Ariz. 291, 599 P.2d 247 (App. 1979). In such a relationship, it may be said that the partners or persons engaged in the common enterprise are subject to a common duty, the breach of which will subject those persons to liability for the entire harm resulting from the failure to perform the duty. *See* Restatement of Torts (Second) § 878 and comment a.

There can be no doubt that the business relationship entered into by ALPHA and Republic contained all of the essential elements of a joint venture, and that any acts of ALPHA or Republic could be imputed to the other. Both owed a common duty to the insureds: the duty to act in good faith.

The same cannot be said of PST. The evidence established that the only function of the trust was to hold the policy and issue certificates of insurance. Testimony indicated that PST was strictly a mechanism for insurance. Therefore, PST was incapable of exercising any control or taking part in any concerted action toward the plaintiffs. Plaintiffs failed to show any active involvement by PST. The instruction regarding joint and several liability in tort as to PST was improper and the judgment against PST must be reversed.

MISREPRESENTATION IN VIOLATION OF THE INSURANCE CODE

The jury was instructed that the defendants could be found liable for misrepresentation in violation of the Arizona Insurance Code. The instruction was based upon § 20-443(1), which provides as follows:

> § 20-443. *Misrepresentations and false advertising of policies.*
>
> No person shall make, issue or circulate, or cause to be made, issued or circulated, any estimate, illustration, circular, sales material or statement:
>
> 1. Misrepresenting the terms of any policy issued or to be issued or the benefits or advantages promised or the dividends or share of the surplus to be received.

Defendants argue that there is no suggestion within the statute that the legislature intended it to serve as a ground for tort recovery. We disagree.

In Sellinger v. Freeway Mobile Homes Sales, Inc., 110 Ariz. 573, 521 P.2d 1119 (1974), this court unanimously held that the Consumer Fraud Act inferentially created a private cause of action for deceptive sales practices. We stated:

> "Although the Act does not specifically provide for a right of action against persons violating the provisions of the article, we believe inferentially such right of action is granted by § 44-1533. It provides:
>
> 'The provisions of this article shall not bar any claim against any person who has acquired any monies or property, real or personal, by means of any practice declared to be unlawful by the provisions of this article.'
>
> Clearly the section quoted contemplates that a person who has been damaged by the practices declared to

> be unlawful may exert a claim by reason of such acts. It has been held that similar language in a consumer fraud act is sufficient recognition that a cause of action has been created in favor of the consumer. Rice v. Snarlin, Inc., 131 Ill.App.2d 434, 266 N.E.2d 183 (1970)."

Id. at 576, 521 P.2d at 1122.

The considerations which lead us to conclude that a private cause of action exists under the Consumer Fraud Act are also present in the context of the Arizona Insurance Code. A.R.S. § 20-443 is found under Chapter 2, Article 6, which deals with unfair practices and frauds in the transaction of the insurance business. Section 20-456 provides that the Director of Insurance, upon a finding that a person has engaged in a prohibited practice under the article, shall issue a cease-and-desist order with regard to the proscribed act or practice and further grants the director authority to impose civil penalties for violation of § 20-443, among others. Subsection C provides:

> "No order of the director pursuant to this section or order of court to enforce it, or holding of a hearing, may in any manner relieve or absolve any person affected by the order or hearing from any other liability, penalty or forfeiture under law."

As in *Sellinger*, we believe that this section contemplates a private suit to impose civil liability irrespective of governmental action against the insurer. *See* Royal Globe Insurance Co. v. Superior Court, 153 Cal. Rptr. 842, 592 P.2d 329 (1979); Greenberg v. Equitable Life Assurance Society, 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973); Craver v. Union Fidelity Life Insurance Co., *supra*.

Defendants nevertheless argue that an instruction on misrepresentation was unwarranted because the trial court had ruled that the brochure was the insurance con-

tract for purposes of the vesting of contractual rights. They maintain that the brochure could not misrepresent the terms of the insurance contract because the insurance contract was the brochure. This argument is specious.

Tort liability under § 20-443 was a separate and distinct issue from the contractual issue. The trial court's ruling on the contract issue had nothing to do with the question of whether the brochure actually misrepresented the terms of the policy. Further, no apparent inconsistency was conveyed to the jury since the trial court judge instructed the jury that the defendants had breached their contract with plaintiffs.

Finally, defendants assert that a cause of action under the Insurance Code, being a liability created by statute, would be barred by the one-year statute of limitations contained in A.R.S. § 12-541(3). *See* Murry v. Western American Mortgage Co., 124 Ariz. 387, 604 P.2d 651 (App. 1979). Although we agree with this argument, defendants failed to raise this defense prior to judgment and it is therefore waived. Romo v. Reyes, 26 Ariz. App. 374, 548 P.2d 1186 (1976).

AGENCY OF ROBERT BOWDEN

The trial court instructed the jury that Robert Bowden had authority to act on behalf of defendants when he spoke to Calvin Sparks about purchasing the group insurance policy. This authority included showing Mr. Sparks the descriptive brochure, and in describing and explaining the insurance coverage provided by defendants. Defendants argue this instruction was erroneous because Bowden was an insurance broker, and under A.R.S. § 20-300, Bowden had no authority to act on behalf of defendants.

§ 20-300(a) provides:

> "A broker, as such, is not an agent or other representative of an insurer and does not have power *by his own acts* to obligate the insurer upon any risk

with reference to any insurance transaction." (Emphasis added).

Defendants' reliance on this statute is misplaced. Section 20-300 does nothing more than define the role of a broker vis-à-vis an insurer.[3] The statute is part of a comprehensive legislative scheme designed to regulate the transaction of business in the insurance industry and the licensing of insurance agents, brokers or solicitors for the protection of the public. A.R.S. § 20-290(A). It merely provides that a "broker" may not "by his own acts" obligate the insurer and does not prevent an insurer from bestowing authority on the broker to perform specified acts.

Under familiar principles of agency law, the broker may be authorized to do an act by a writing or other conduct of the insurer which, reasonably interpreted, causes the broker to believe that the insurer desires him to act on the insurer's behalf. *See* Restatement (Second) of Agency § 26 (1958). Once the insurer authorizes the broker to conduct a certain transaction, the insurer is liable to third persons upon contracts made by the broker acting within his authority. However, such contracts must be in proper form and with the understanding that the insured is a party. *See* Restatement (Second) of Agency §§ 140, 144 (1958). This is especially true where the insurer has ratified the transaction. Daru v. Martin, 89 Ariz. 373, 363 P.2d 61 (1961); Fuqua Homes, Inc. v. Grosvenor, 116 Ariz. 424, 569 P.2d 854 (App. 1977).

The evidence showed that ALPHA and Republic contemplated that independent insurance brokers such as Bowden would solicit customers for their insurance. Defendants supplied Bowden with copies of the sales brochure and applications for the group insurance. Bowden

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[3] *See also* A.R.S. § 20-283 (defining "broker" as "an independent contractor"); Washington Nat'l Ins. Co. v. Employment Security Comm'n, 61 Ariz. 112, 114 P.2d 688 (1944) ("broker" is one who acts as a middleman between the assured and the insurer.)

was also required by defendants to certify that he had explained "in detail the coverage to the new member firm." These acts bestowed authority upon Bowden to solicit prospective insureds and to explain the terms of the policy. Even if Bowden had committed an unauthorized act, defendants ratified Bowden's conduct by accepting plaintiffs' application for insurance.

There is also evidence in the record which disputes defendants' claim that Bowden was merely a broker and not an agent of the defendants. Bowden was listed as an agent for Republic in Republic's answer to interrogatories. This response was reaffirmed by Republic's house counsel at trial.

Finally, there is no evidence which indicates that Bowden did anything to exceed the scope of his authority. Plaintiffs presented no evidence that Bowden made any statements contrary to the express terms of the brochure.

Defendants respond, nonetheless, that the question of Bowden's agency constituted an issue of fact which should have been decided by the jury. While it is true that the question of whether an agency existed is one of fact, Corral v. Fidelity Bankers Life Insurance Co., 129 Ariz. 323, 630 P.2d 1055 (App. 1981), when the material facts from which the agency relationship could be inferred are not in dispute, the question of whether an agency relationship exists is a question of law for the court. Cote v. A. J. Bayless Markets, Inc., 128 Ariz. 438, 626 P.2d 602 (App. 1981). We believe that the undisputed facts support the conclusion that Bowden was authorized to act on behalf of the defendants. The instruction on Bowden's agency was proper.

ATTORNEY'S FEES

After a hearing was conducted on the issue of attorney's fees, the trial court awarded $80,000 to plaintiffs pursuant to A.R.S. § 12-341.01. Defendants contest the award in two respects.

First, defendants argue the award was improper because the tort claims of bad faith and misrepresentation under the Insurance Code dominated the case, and § 12-341.01 allows recovery of attorney's fees only in contract cases. In support, defendants rely heavily on Amphitheater Public Schools v. Eastman, 117 Ariz. 559, 574 P.2d 47 (App. 1977). Plaintiffs maintain that the tort claims were actions "arising out of a contract" and therefore, the statute applies.[4]

The language employed in subsection (A) makes clear that attorney's fees are recoverable only in cases "arising out of a contract." The language is broad enough, however, that it could be argued, as plaintiffs do here, that attorney's fees may be recoverable in tort cases which find their basis in contract. Such an argument was rejected in *Amphitheater, supra.* In that case, the plaintiff had left her car with an instructor in an auto mechanics

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[4] § 12-341.01 Recovery of attorney's fees

A. In any contested action arising out of a contract, express or implied, the court may award the successful party reasonable attorney's fees. This section shall in no manner be construed as altering, prohibiting or restricting present or future contracts or statutes that may provide for attorney's fees.

B. The award of reasonable attorney's fees awarded pursuant to subsection A should be made to mitigate the burden of the expense of litigation to establish a just claim or a just defense. It need not equal or relate to the attorney's fees actually paid or contracted, but such award may not exceed the amount paid or agreed to be paid.

C. Reasonable attorney's fees shall be awarded by the court in any contested action upon clear and convincing evidence that the claim or defense constitutes harassment, is groundless and not made in good faith. In making such award, the court may consider such evidence as it deems appropriate and shall receive this evidence during trial on the merits of the cause, or separately, regarding the amount of such fees as it deems in the best interest of the litigating parties.

D. Reasonable attorney's fees awarded under the provisions of this section shall be awarded by the court and not by a jury.

program conducted by the defendant school for an assessment of needed repairs. The instructor asked a student to notify the plaintiff's son that he should pick up his mother's car that day. The instructor stated in front of fifteen other students that he would leave the keys in the ignition. The car was later stolen. Plaintiff, the successful party, sought attorney's fees under § 12-341.01 on the theory that her claim arose out of a contract of bailment. The Court of Appeals, Division Two, responded to this argument by stating:

> "Her complaint contains one count in negligence and another charging breach of the bailment contract in the negligent failure to care for her car. Regardless of the label on the second count, the essence of her claim is negligence, and the statute has no application."

Id. at 560, 574 P.2d at 48.

The continued validity of this holding was cast in serious doubt by our decision in Wenk v. Horizon Moving & Storage Co., —— Ariz. ——, 639 P.2d 321 (1982). In *Wenk*, plaintiffs brought an action against a moving and storage company to recover the value of some lost items of furniture. Plaintiffs alleged both a breach of a bailment contract and negligence in the loss of their property. The trial court awarded damages in favor of plaintiffs based upon conclusions of law that there was 1) a common-law bailment and 2) the moving company had failed to exercise ordinary and reasonable care in handling the items. Plaintiffs' request for attorney's fees pursuant to § 12-341.01 was denied and plaintiffs appealed the denial of attorney's fees. In effect, we held that attorney's fees could be awarded based upon the common-law bailment.

It is apparent from the Wenk case that attorney's fees may be awarded pursuant to § 12-341.01(A) based upon facts which show a breach of contract, the breach of which may also constitute a tort. The fact that the two legal

theories are intertwined does not preclude recovery of attorney's fees under § 12-341.01(A) as long as the cause of action in tort could not exist *but for* the breach of the contract.

With this in mind, we turn to the question of whether the torts of insurer's bad faith and misrepresentation under § 20-443 are actions "arising out of a contract."

In Noble v. National American Life Insurance Co., *supra*, we stated that "it is reasonable to conclude that *there is a legal duty implied in an insurance contract* that the insurance company must act in good faith in dealing with its insured on a claim, and a violation of that duty of good faith is a tort." 128 Ariz. at 190, 624 P.2d at 868 (emphasis added). Clearly, the tort of bad faith cannot be committed absent the existence of an insurance contract and a breach thereof. Because the existence of the tort is so intrinsically related to the contract, we conclude that an action alleging insurer's bad faith is one "arising out of a contract" within the meaning of § 12-341.01(A).[5]

The same cannot be said for an action for misrepresentation under § 20-443. Such an action sounds mainly in tort and its existence does not depend upon a breach of the contract of insurance. In most cases, an action under § 20-443 would arise after the insured discovered that the contract he entered was not as represented in the sales material. The insured may be bound by the contract if he had notice of its terms before a claim was submitted, *cf.* Sahlin v. American Casualty Co. of Reading, *supra*, but a cause of action available under § 20-443 may nevertheless provide the insured with a remedy. The tort committed by the insurer in this situation would not involve a breach of the actual contract; therefore, it would not be an action arising from a contract.

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[5] It is also conceivable that attorney's fees may be awarded pursuant to subsection (C) in a bad-faith action.

Although we hold that attorney's fees are not recoverable under § 12-341.01(A) for misrepresentation under the Insurance Code, this does not require us to reduce or vacate the award in the instant case.

During the hearing on the issue of attorney's fees, plaintiffs introduced testimony from respected members of the bar, including a former judge of the Court of Appeals, setting an estimate of reasonable attorney's fees in this case in the range of $62,000 to $225,000. One witness testified that in arriving at his own estimate, he ignored the punitive award because he felt the "initial verdict would have flown from the contract under whatever theory was vouched." Although admitting that it was difficult to separate the contractual aspects from the verdict, the witness concluded, "I felt certainly that the case arose from the breach of contract, and I think in fairness to everybody concerned that those figures [$175,000 to $225,000] are, in my opinion, justified by the case." In view of the testimony which estimated reasonable attorney's fees in amounts substantially higher than those actually awarded, we believe the $80,000 award was proper and was within the court's discretion.

Second, defendants protest an order of the trial court which prevented them from examining the fee agreement between plaintiffs and their counsel. Defendants argue that they are entitled to discovery of the fee contract in order to determine the statutory limitation for an award of attorney's fees under § 12-341.01(B), and that the refusal to permit discovery was violative of due process.

Subsection (B) provides that the award "need not equal or relate to the attorney's fees actually paid or contracted, but such an award may not exceed the amount paid or agreed to be paid." Defendants are correct in their assertion that subsection (B) sets a limit on the amount the court may award pursuant to § 12.341.01(A);

however, we disagree with defendants' argument that they are entitled to examine the fee contract. The trial court examined the fee agreement *in camera* before making its award, thus assuring itself that the final award did not exceed the amount agreed to be paid.

Due process requires that a party be given notice and an opportunity to be heard and, to give substance to the hearing, the court must consider and appraise the evidence which justifies its determination. State v. Essman, 98 Ariz. 228, 403 P.2d 540 (1965). A full hearing was conducted on the issue of attorney's fees. Defendants were afforded an opportunity to cross-examine plaintiffs' witnesses and to present their own evidence in rebuttal. The trial judge, having examined the fee agreement, was able to make an award based upon the evidence and with the limitation of § 12-341.01(B) in mind. The hearing and the judge's personal inspection of the fee agreement adequately safeguarded defendants' due-process rights.

Defendants raise a final, and somewhat novel, argument. They submit that attorney's fees may not be awarded under § 12-342.01(B) when the contract between the party and the attorney is a contingency-fee agreement. They reason that under such an agreement, the client is not obligated to pay the attorney anything, but only shares with counsel such recovery as may be obtained.

We cannot agree that a contingency-fee agreement does not obligate a party "to pay attorney's fees from his own pocket," as defendants suggest. After obtaining a judgment, a client who has retained counsel on a contingency basis must surrender the agreed upon percentage of the judgment as remuneration. This is certainly an "expense of litigation" under subsection (B). The award of attorney's fees mitigates the burden of the expense of litigation by offsetting the amount due the at-

torney. Therefore, we hold that subsection (B) allows an award of attorney's fees when a contingency-fee agreement is involved.

The judgment of the Superior Court is affirmed as to defendants ALPHA and Republic. The judgment is reversed as to defendant PST and remanded for proceedings consistent with this opinion.

JACK D. H. HAYS
Justice

Concurring:

FRANK X. GORDON, JR.
Vice Chief Justice

JAMES DUKE CAMERON
Justice

HOLOHAN, Chief Justice, concurring:

I concur in the result.

WILLIAM A. HOLOHAN
Chief Justice

FELDMAN, Justice, specially concurring

I concur with the result and agree with the thorough exposition contained in the majority opinion. I write only to state my belief that under the facts of this case it is not necessary to examine the actual policy in order to conclude that there is coverage for post-termination expenses incurred as the result of a pre-termination injury.

As the majority opinion indicates, the brochure failed to inform the insured that expenses for a pre-termination injury would not be paid after termination. Such an explanation might have conveyed to the insured the alarming idea that if he sustained a permanently and completely disabling injury which prevented him from continuing to keep the policy in force, the insurer could not only terminate the policy but could also terminate its existing obligation to pay continuing medical expenses for injuries which had occurred while the policy was in force. Without such an explicit statement, the ordinary consumer reading the brochure would have a reasonable expectation that when a covered injury occurred while the policy was in full force, the company would be bound to continue to pay benefits up to the policy limits.

Thus, while I agree that there is an ambiguity when the policy is compared to the brochure, I think we need not even reach that question. Because the insurer advertised and sold the coverage through the brochure, and provided the insured with no other information, I would simply hold that the insurer is bound by the writing which contains all the coverage agreements given its insured. The insurer cannot defeat coverage by raising unusual exclusions or termination rights not contained in the information given the insured. It cannot rely upon the provisions of a master policy never shown the insured and from a practical standpoint not even available to him—in order to subtract from the coverage reasonably to be expected by the insured after reading the sales

material and information which was given him. *See* Preferred Risk Mutual Insurance Co. v. Thomas, 372 F.2d 227, 230-31 (4th Cir. 1967); Lecker v. General American Life Insurance Co., 55 Hawaii, 624, 525 P.2d 1114 (1974); Lewis v. Continental Life & Accident Co., 93 Idaho 348, 461 P.2d 243 (1969); Van Vactor v. Blue Cross Ass'n., 50 Ill. App.3d 709, 8 Ill. Dec. 400, 365 N.E.2d 638 (1977).

An insurer which has led its insured to believe that a risk is covered cannot be permitted to use an undelivered contract to prove the contrary. Preferred Risk Mutual Insurance Co., *supra*. Significant policy exclusions contained in an undistributed master contract but omitted from the brochure distributed to policyholders cannot be enforced. Van Vactor v. Blue Cross, *supra*.

Of course, my conclusion that the company is bound by the coverage reasonably to be inferred from its sales material does not in any way detract from the holdings reached in the majority opinion and, in fact, would make all the conclusions which flow from a finding of post-termination coverage, including the holding on "bad faith", even more compelling.

STANLEY G. FELDMAN
Justice

IN THE SUPREME COURT
OF THE STATE OF ARIZONA
En Banc

No. 15488

CALVIN C. SPARKS and SUZANNE SPARKS,
husband and wife,
Appellees,

v.

REPUBLIC NATIONAL LIFE INSURANCE COMPANY, a Texas corporation; AMERICAN LIFE PENSION HEALTH ASSOCIATES CORPORATION, an Iowa corporation, dba ALPHA CORPORATION, PLANNED SECURITY TRUST, a trust,
Appellants.

[Filed Jul. 15, 1982]

SUPPLEMENTAL OPINION

Appeal from the Superior Court of Maricopa County

The Honorable Philip W. Marquardt, Judge

(Cause No. C-402143)

MOTIONS FOR REHEARING DENIED

Holland & Postal
By Robert W. Holland — Phoenix
Attorneys for Appellants

Jennings, Strouss & Salmon
By William T. Birmingham,
Richard B. Burnham and
Ted A. Schmidt — Phoenix
Attorneys for Appellees

HAYS, Justice

The jury instructions in this case were given before this court's decision in Noble v. National American Life Insurance Co., 128 Ariz. 188, 624 P.2d 866 (1981). In the case at issue, the challenged instructions on the tort of bad faith were held not to constitute reversible error. We, however, do not approve the use of those instructions in future cases. Our case of *Noble* sets out the principles which should be embodied in instructions on cases involving the tort of bad faith.

The motions for rehearing are denied.

JACK D. H. HAYS
Justice

Concurring:

WILLIAM A. HOLOHAN
Chief Justice

FRANK X. GORDON, JR.
Vice Chief Justice

JAMES DUKE CAMERON
Justice

STANLEY G. FELDMAN
Justice

IN THE SUPERIOR COURT
OF THE STATE OF ARIZONA
IN AND FOR THE COUNTY OF MARICOPA

No. C 402143

CALVIN D. SPARKS and SUZANNE SPARKS,
husband and wife,
Plaintiffs,

v.

REPUBLIC NATIONAL LIFE INSURANCE COMPANY,
a Texas corporation, et al.,
Defendants.

JUDGMENT

The above-captioned case having been set for trial and trial having commenced on the 26th day of August, 1979, the Honorable Philip W. Marquardt, presiding; the Plaintiffs having presented evidence and the Defendants having presented evidence; the Court having granted Defendants a directed verdict against Plaintiffs on their claim for recovery premised upon constructive fraud, common law fraud, violation of the Arizona Consumer Fraud Act, negligent misrepresentation, and intentional infliction of emotional distress; the Court having instructed the jury and the jury having rendered its verdict, on September 4, 1980, in favor of the Plaintiffs, Calvin D. Sparks and Suzanne Sparks, husband and wife, and against Defendants, Republic National Life Insurance Company, a Texas corporation; American Life Pension Health Associates Corporation, an Iowa corporation, dba ALPHA Corporation and dba Planned Security Trust and Planned Security Trust, a trust, and having awarded Plaintiffs compensatory damages in the amount of ONE MILLION FIVE HUNDRED FIFTY ONE THOUSAND AND XX/100 DOLLARS ($1,551,000.00), and punitive damages in the amount of THREE MILLION and XX/100 DOLLARS ($3,000,000.00);

NOW, THEREFORE, IT IS ORDERED, ADJUDGED AND DECREED that Plaintiffs, Calvin D. Sparks and Suzanne Sparks, husband and wife, have judgment against the Defendants, Republic National Life Insurance Company, a Texas corporation, American Life Pension Health Associates Corporation, an Iowa corporation, dba ALPHA Corporation and dba Planned Security Trust and Planned Security Trust, a trust, for compensatory damages in the amount of ONE MILLION FIVE HUNDRED FIFTY ONE THOUSAND and XX/100 DOLLARS ($1,551,000.00), punitive damages of THREE MILLION and XX/100 DOLLARS ($3,000,000.00) with interest on said compensatory and punitive damages at the statutory rate from September 4, 1980 until paid, attorneys' fees of EIGHTY THOUSAND and XX/100 DOLLARS ($80,000.00) and Plaintiffs' taxable costs herein incurred with interest on said attorneys' fees and taxable costs at the statutory rate from the date of this Judgment until paid.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that there is no just reason for delay in entry of this Judgment and that, pursuant to Rule 54(b), Arizona Rules of Civil Procedure, the Clerk is directed to enter this Judgment forthwith.

DONE IN OPEN COURT this 23 day of September, 1980.

/s/ _____

PHILIP W. MARQUARDT
Judge of the Superior Court

IN THE SUPERIOR COURT
OF THE STATE OF ARIZONA
IN AND FOR THE COUNTY OF MARICOPA

Supreme Court No. 15488

Court of Appeals No. 1 CA-CIV 5747

Maricopa County No. C-402143

CALVIN C. SPARKS and SUZANNE SPARKS,
husband and wife,
Plaintiffs,

v.

REPUBLIC NATIONAL LIFE INSURANCE COMPANY, a Texas corporation; AMERICAN LIFE PENSION HEALTH ASSOCIATES CORPORATION, an Iowa corporation, dba ALPHA CORPORATION, PLANNED SECURITY TRUST, a trust,
Defendants.

JUDGMENT ON MANDATE AND AGAINST SURETY ON SUPERSEDEAS BOND

On September 23, 1980, this Court's judgment was entered ordering that the plaintiffs have judgment.

Defendants presented a timely appeal. On June 10, 1982, the Supreme Court in CALVIN C. SPARKS and SUZANNE SPARKS, husband and wife, v. REPUBLIC NATIONAL LIFE INSURANCE COMPANY, a Texas corporation; AMERICAN LIFE PENSION HEALTH ASSOCIATES CORPORATION, an Iowa corporation, dba ALPHA CORPORATION, PLANNED SECURITY TRUST, a trust, Supreme Court No. 15488, rendered its opinion affirming the judgment of this Court against REPUBLIC NATIONAL LIFE INSURANCE COMPANY, a Texas corporation, ("Republic") and AMERICAN LIFE PENSION HEALTH ASSOCIATES CORPORATION, an Iowa corporation, dba ALPHA CORPORATION, ("Alpha").

Defendants made a timely motion for rehearing, which was denied.

On July 16, 1982, the Supreme Court transmitted its mandate to this Court, commanding that such proceedings be had as shall be required to comply with its opinion.

On December 5, 1980, Aetna Life & Casualty, a Connecticut corporation, ("Aetna") executed and filed a supersedeas bond herein binding themselves, as surety, for payment of the judgment, interest and all accruing costs if the judgment was affirmed on appeal. Said judgment having been affirmed, Aetna is liable for the underlying judgment and costs and fees on appeal.

Therefore, in accordance with the Opinion and Mandate of the Supreme Court, and the Judgment and Statement of Costs filed in this Court, and the Court expressly determining, pursuant to Rule 54(b) Arizona Rules of Civil Procedure, that there is no just reason for delay in entry of this judgment,

IT IS ORDERED, ADJUDGED AND DECREED that the plaintiffs have judgment as follows:

1) Against REPUBLIC NATIONAL LIFE INSURANCE COMPANY, a Texas corporation, and AMERICAN LIFE PENSION HEALTH ASSOCIATES CORPORATION, an Iowa corporation, dba ALPHA CORPORATION, and AETNA LIFE & CASUALTY, a Connecticut corporation, on the mandate, jointly and severally, for costs on appeal in the amount of $34,435.50, with interest thereon at the rate of 10% per annum from the date of this judgment until paid.

2) Against AETNA LIFE & CASUALTY, a Connecticut corporation on its supersedeas bond No. 61 S 34292 BCA dated December 5, 1980, in the amount of $4,551,000.00 with interest thereon at 10% per annum from September 4, 1980, until paid and in the further amount

of $80,650.25 with interest thereon at 10% per annum from September 23, 1980, until paid.

3) It is further ordered that the stay of execution on this Court's judgment of September 23, 1980, against defendants REPUBLIC NATIONAL LIFE INSURANCE COMPANY, a Texas corporation, and AMERICAN LIFE PENSION HEALTH ASSOCIATES CORPORATION, an Iowa corporation, dba ALPHA CORPORATION, pursuant to Rule 7, Rules of Civil Appellate Procedure, be, and hereby is, quashed and said judgment is now fully enforceable.

4) The Clerk of the Court is directed to enter this judgment forthwith.

DONE IN OPEN COURT this 21st day of July, 1982.

/s/ _____
Judge of the Superior Court

SUA SPONTE GRANT OF DIRECTED VERDICT BY TRIAL COURT

MR. SCHMIDT [counsel for plaintiffs]: At this time the plaintiffs rest.

* * * *

THE COURT: With the concurrence of counsel, I have just excused the jury. The Reporter was not present. I believe counsel were standing behind me.

* * * *

THE COURT: Time for motions.

Plaintiffs have rested.

MR. HOLLAND: Your Honor, the defendants propose to present at this time a series of motions to the Court.

* * * *

[THE COURT:] I think we have an estoppel situation. I think Exhibit 1 [the sales brochure] is—(A), I don't think it's ambiguous at all. I think it clearly says to me that on its face that the obligation of the defendant for injuries runs beyond the termination of the contract until its limits are reached.

In other words, that my reading of the contract, and I see it as a matter of law, that right on that contract it says you get to have —once you're injured you continue with those benefits, even though the contract terminates.

But let's assume that I am not going to be limited to that ruling, because I also find that even if it's not as a matter of law clear on its face, I find Exhibit 1 to be so ambiguous that I would have to rule against the insurance company in favor of the plaintiffs and find that again the obligation of the defendant for injuries to the plaintiff runs beyond the termination of the contract until the limits of the policy are reached.

I find that the plaintiffs' rights to receive benefits vest at the time of the injury, and continue on until the limits are exhausted. So, I find that those are two findings that I would make.

* * * *

Further, in view of the fact that the defendants are—I think they're further estopped because of the fact that they accepted money and continued on paying benefits during the term of the policy. I think that is—as a matter of law—is a decision that this Court has a right to make, and I so make it, removing from the jury those issues.

At this point I think the only thing that we can—I'll be glad to talk this over Tuesday, where we are going to head from here—is the question whether any issue should be submitted to the jury on the other factual theories that the plaintiff has brought forth: That is, consumer fraud, fraud, intentional misrepresentation. I haven't made a decision on that yet, because it hasn't been argued. And also the argument as to whether the issue of bad faith and whether the issue of punitives should be issued to the jury.

EXCERPTS FROM JURY INSTRUCTIONS AS GIVEN IN THE MARICOPA COUNTY SUPERIOR COURT

• • • •

[69] I will now tell you the rules that you must follow to decide this case. I will instruct you on the law. It is your duty to follow the law.

• • • •

[72] I have determined that Republic, PST and Alpha Corporation were acting jointly and severally in selling the insurance, circulating literature concerning it, and in deciding whether or not to pay claims under it.

I have determined that defendants breached their contract with plaintiff by refusing to pay benefits after December 1977. Plaintiffs claim that defendants also breached their covenant of good faith and fair dealing.

Under Arizona law, every insurance contract contains an implied promise of good faith and fair dealing which the insurance company owes to its insured. This promise imposes an obligation on the insurance company to deal fairly in handling a claim made by its insured under the policy and to not unreasonably withhold payment of promised benefits of its insured.

Reasonableness is to be determined on the basis of whether the conduct of the insurer was justified and reasonable under the circumstances found herein.

• • • •

[74] Although punitive damages cannot be awarded for a breach of contract alone, if you find that defendants breached their covenant to exercise good faith and fair dealing with the Sparks or violated the Arizona Insurance Code and this conduct demonstrated reckless indifference to the interests and welfare of the Sparks or willful or wanton conduct, you may in your discretion award punitive damages in an amount which you feel will adequately

punish defendants for their conduct in the past and deter future wrongdoing and to deter other persons in like circumstances from engaging in similar conduct.

• • • •

[75] If you decide to award punitive damages against the defendants, in determining the amount of punitive damages to be awarded, you may consider the financial worth or wealth of the defendants.

• • • •

REPUBLIC NATIONAL LIFE INSURANCE COMPANY

PARENT

GULF UNITED CORPORATION

Affiliates

Affiliated Services, Inc.
Alico Management Company
American-Amicable Life Insurance Company
Down-Tel Corporation
Equitable Life Insurance Company
Executive Advertising Incorporated
Financial Computer Services Inc.
First Elico Corporation
Georgetown Realty Inc.
GUC Corporation
GUDC, Inc.
Gulf Broadcast Company
Gulf Broadcast Group
Gulf Equities Incorporated
Gulf Group Services Corp.
Gulf Life Center Dev. Co.
Gulf Life Group Insurance Co.
Gulf Life Insurance Company
Gulf Master Company
Gulf National Land Corporation
Gulf Regency Company
Gulf Village Inc.
Gulf United Corporation of Texas
Gulf United Indiana Corporation
Gulfco Capital Management, Inc.
Hadco Inc.
Insured Benefit Plans Services, Inc.
Interstate Fire Insurance Company
Invesco Inc.

Kool Radio-Television, Inc.
KTXQ, Inc.
Lenders Indemnity Inc.
Pioneer-American Insurance Company
Real Estate Development Corp.
Republic National Life Group Insurance Company
Southwestern Drug Corporation
Southwestern Drug Corporation of Louisiana
St. Johns Place Co
U.S. Life Insurance Company of Texas
WGHP-TV, Inc.
WKAP, Inc.
WNDE-WFBO
WTSP-TV, Inc.
WVOJ, Inc.
WWNR

Office - Supreme Court, U.S.
FILED
NOV 16 1982
EX ... REVAS.

No. 82-645

In The
Supreme Court of the United States

October Term, 1982

REPUBLIC NATIONAL LIFE INSURANCE COMPANY
and
AMERICAN LIFE PENSION HEALTH ASSOCIATES, INC.,
Petitioners,

v.

CALVIN C. SPARKS AND SUZANNE SPARKS,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ARIZONA

WILLIAM T. BIRMINGHAM
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QUESTIONS PRESENTED

1. Should this Court grant certiorari when the only claims raised by the Petitioners to challenge the jury verdict were waived below?

2. Should this Court review the decision of the highest court of Arizona holding that the insurance documents at issue gave rise to contract liability as a matter of state law?

3. Does the decision of the Arizona Supreme Court that jury instructions used in this case adequately instructed the jury on the tort of bad faith raise a substantial constitutional question which this Court should review?

4. Where, for the first time in a motion for rehearing of the Arizona Supreme Court's decision, Petitioners argued that reversal of the judgement against a subsidiary entity of one codefendant also necessarily required reversal of the punitive damage verdict against all defendants, but both state law and the evidence at the trial support the verdict as to the other codefendants, should this Court grant certiorari to review the decision?

5. Was the trial court's *in camera* review of Respondents' attorneys' fee agreement to assure the propriety of the attorneys' fee award under Arizona law a denial of due process to Petitioners?

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In The
Supreme Court of the United States

October Term, 1982

No. 82-645

REPUBLIC NATIONAL LIFE INSURANCE COMPANY

and

AMERICAN LIFE PENSION HEALTH ASSOCIATES, INC.,

Petitioners,

v.

CALVIN C. SPARKS AND SUZANNE SPARKS

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ARIZONA

Respondents, Calvin C. Sparks and Suzanne Sparks, husband and wife, pray that this court deny the petition for a writ of certiorari filed on October 13, 1982.

OPINION BELOW

The citation to the Opinion and Supplemental Opinion of the Supreme Court of the State of Arizona is *Calvin C. Sparks and Suzanne Sparks v. Republic National Life Insurance Company,* _____ Ariz. _____, 647 P.2d 1127 (1982).

STATUTES INVOLVED

In addition to the constitutional provision cited by Petitioners, this case involves Arizona Revised Statute § 12-341.01 and 28 U.S.C. § 1257 the relevant parts of which are set forth hereafter.

STATEMENT OF THE CASE

On September 4, 1980, eight jurors unanimously returned a verdict for compensatory and punitive damages against Petitioners because of their outrageous and tortious denial of insurance benefits on the basis of "patently ambiguous and previously undisclosed provisions in the insurance policy" ultimately issued to Calvin Sparks. *Sparks*, 647 P.2d at 1137. Calvin Sparks required continuing treatment arising from extensive brain damage and other injuries he had received in an airplane accident on May 1, 1977, and five-year old Kevin Sparks required continuing treatment of medical conditions arising from paraplegia sustained in the accident. Petitioners' termination of health insurance resulted in actual physical harm to Calvin and Kevin Sparks.

The health insurance policy had been purchased by Calvin to protect his family and the few employees of his small business, Sun Valley Sales & Air Conditioning. It was uncontradicted at trial that the only conversations concerning purchase of the insurance were between Calvin Sparks and Petitioners' agent, Robert Bowden. It was further uncontradicted that the only written information concerning the insurance Mr. Sparks saw before his premium check was accepted and the accident occurred was an eight-page brochure describing the insurance.

Mr. Sparks purchased the policy in reliance upon the brochure and oral statements of Robert Bowden, each of which unequivocally promised $250,000 per person coverage for medical care made necessary by an illness or accident sustained while the insurance was in force (irrespective of later termination of the insurance policy).

After purchase of the insurance but *prior* to delivery of the master policy to Mrs. Sparks, Calvin and Kevin Sparks were injured in the accident. Even if Mrs. Sparks had understood the ambiguous policy as meaning what Petitioners urged below, she could not have rejected it and bought different coverage at the time she received it since the catastrophic injuries had already been sustained by her husband and son.

Sun Valley Sales failed after the accident because permanent mental impairment rendered Mr. Sparks incapable of managing its affairs. The business was thus unable to continue premium payments for the insurance. Petitioners terminated all insurance benefits in December of 1977 claiming that the master policy provided that continuing benefits for a prior illness or accident were conditioned upon continuing premium payments.

The Sparks filed suit and proceeded to an eight-day trial in August, 1980 in the Maricopa County Superior Court. At the close of plaintiffs' case defendants moved for a directed verdict finding that they were not liable under the contract to pay continuing benefits to the Sparks. The trial court denied the directed verdict on the basis that the insurance documents obligated defendants to provide continuing benefits despite the ultimate nonpayment of premiums.

At the end of the *defendants'* case, the court directed a verdict for plaintiffs on the contract liability issue and, in part, instructed the jury that tort liability could be found if defendants had acted in bad faith by having "unreasonably with[held] payment of promised benefits" and denied the claims in a manner which was "not justified and reasonable under the circumstances." *Sparks*, 647 P.2d at 1136. The jury was also instructed that tort damages could be awarded if defendants had misrepresented the terms of the master policy in the brochure in violation of the Arizona Insurance Code.

Subsequent to return of the verdict, the trial court held an evidentiary hearing regarding plaintiffs' request for attorneys' fees pursuant to Arizona Revised Statutes § 12-341.01.1.[1] Plaintiffs were awarded $80,000 after the court determined, as required by the statute, that this amount *did not exceed* the amount that they had actually agreed to pay their counsel. To make this determination, the court reviewed the contingent fee agreement *in camera* after plaintiffs asserted the attorney-client privilege as to the particulars of the fee agreement. At the evidentiary hearing, however, the Sparks' counsel freely testified to the fact that the agreement was contingent and that the contingent fee would exceed the $80,000 which was awarded by the trial court.

Petitioners took their appeal after entry of judgment by the trial court. Petitioners raised six issues on appeal, all of which were carefully and accurately noted in the Opinion. 647 P.2d at 1132. The only federal question *ever* raised, either at trial or on appeal, was the Petitioners' contention that the trial court's *in camera* review of the contingent fee agreement somehow denied them due process in the award of attorneys' fees. Consistent with Petitioners' presentation of the issues, the Arizona Supreme Court did not address any other federal question in the Opinion issued June 10, 1982, affirming the judgment against Petitioners.

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[1] This statute provides, in part, as follows:

A. In any contested action arising out of a contract, express or implied, the court may award the successful party reasonable attorney's fees. This section shall in no manner be construed as altering, prohibiting or restricting present or future contracts or statutes that may provide for attorney's fees.

B. The award of reasonable attorney's fees awarded pursuant to subsection A should be made to mitigate the burden of the expense of litigation to establish a just claim or a just defense. It need not equal or relate to the attorney's fees actually paid or contracted, but such award may not exceed the amount paid or agreed to be paid.

On July 15, 1982, the Arizona Supreme Court issued a one paragraph Supplemental Opinion denying rehearing which simply held that the jury instruction on bad faith did not constitute reversible error and that the court did not sanction use of the precise language from the *Sparks* instruction as a model for future cases.[2]

After denial of the motion for rehearing, judgment on the mandate was entered by the superior court on July 21, 1982. Subsequently, Petitioners moved the Arizona Supreme Court to stay enforcement of the judgment pending filing of a petition for a writ of certiorari in the United States Supreme Court. The stay was denied by order dated July 22, 1982. Petitioners then sought a stay of enforcement of the judgment from this Court pursuant to 28 U.S.C. § 2101(f) (1982). This was denied by order of Justice Rehnquist on July 23, 1982. The judgment was then satisfied by Petitioners.

SUMMARY OF ARGUMENT

This case involves issues of contract interpretation and tort liability under Arizona law. No federal or constitutional issue which challenged the verdict was ever raised until the filing of the Petition and none actually exists. In effect, the Petitioners argue that the trial court and Arizona Supreme Court are so wrong in their rulings on jury instructions and other state law questions that their actions amount to arbitrary and capricious conduct, constituting a denial of due process of law under the Fourteenth Amendment. The claim borders on the frivolous. There is no federal question or other reason for this Court to review the Opinion of the Arizona Supreme Court.

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[2] The Supplemental Opinion thus assured amici that future bad faith defendants could request jury instructions containing exact language from the case of *Noble v. National American Life Insurance Company*, 128 Ariz. 188, 624 P.2d 866 (1981), which was decided *after* this case was tried; such language was not requested by defendants in this case when instructions were settled.

Respondents' argument, summarized, is as follows:

1. The three claims raised by Petitioners to challenge the verdict were waived below. There is no jurisdiction to consider these issues. Moreover, they could have no effect on the judgment because of the doctrine of adequate state grounds.

. The trial court did not *sua sponte* grant a directed verdict for plaintiffs at the close of plaintiffs' case in chief as Petitioners now claim. The trial court, rather, denied *defendants'* motion for a directed verdict on the question of contract liability and, in the course of explaining its ruling, outlined its interpretation of the contractual documents, which is a decision for the court under Arizona law. The Arizona Supreme Court correctly affirmed the trial court's ruling that petitioners were liable under their insurance contract as a matter of state law. No legitimate federal or constitutional issue is raised by Petitioner's claim.

3. The Opinion of the Arizona Supreme Court is a carefully researched and thorough exposition of Arizona law on the tort of bad faith. The refusal of the Arizona Supreme Court to determine that the bad faith jury instruction was reversible error under Arizona law was not arbitrary and capricious state action denying Petitioners their Fourteenth Amendment rights.

4. The reversal of the verdict as to defendant Planned Security Trust ("PST") raises no constitutional question as to the verdict against Petitioners. PST was a subsidiary entity of Petitioner ALPHA with no purpose other than to hold Republic's insurance policy. PST could undertake no action without direction from ALPHA. There was no evidence of any financial worth of PST. Inclusion of PST as a jointly-liable party in the jury's consideration of damages could have had no improper effect on the verdict so as to require a reversal for Republic and ALPHA under common law principles.

5. The trial court's *in camera* review of the attorneys' fee agreement did not deprive Petitioners of their due process rights in connection with the $80,000 attorneys' fee award. The fee agreement was not substantively considered by the court in determining its award; Petitioners were fully allowed to cross-examine witnesses with regard to the germane considerations under the statutory provision authorizing the fee award. This is the only federal claim preserved below, but there is no special and important reason to consider it, nor does it meet the enumerated criteria for granting certiorari.

REASONS WHY THE WRIT SHOULD BE DENIED

I. Petitioners Failed to Preserve Federal Question Jurisdiction Over the Claims Which Seek to Attack the Verdict.

The three constitutional "issues" raised by Petitioners as reasons for this Court to review the verdict were waived at *both* the trial and appellate levels of the state court proceedings. It is settled Arizona law that "[t]he failure to raise an issue either at the trial level or in briefs on appeal constitutes a waiver of the issue." *Van Loan v. Van Loan*, 116 Ariz. 272, 274, 569 P.2d 214, 216 (1977); *Goldwaters Inc. v. Medar*, 82 Ariz. 344, 313 P.2d 410 (1957). The only federal question preserved in the state proceedings concerned the award of attorneys' fees.

Contrary to Petitioners' assertion, no issue on appeal was ever advanced that error had been committed by the supposed *"sua sponte"* grant of a directed verdict on contract liability for the plaintiffs at the close of their case. Though the Petitioners commented on this twice in their opening appellate brief it was never framed as an issue or mentioned as a due process question. Similarly, though Petitioners argued on appeal that the bad faith instruction given to the jury was improper under the subsequent Arizona Supreme Court opinion in *Noble v. National American*, *supra*, their argument was framed solely in

terms of state law. Petitioners implicitly concede that they never argued below that the jury instruction given by the trial court, and affirmed by the Arizona Supreme Court, denied them due process. (Petition at 5).

Finally, though they argued that the three defendants were not jointly and severally liable, Petitioners never argued prior to their motion for rehearing that a reversal as to one or more defendants on the joint and several liability question should entail modification or reversal of the damage awards against the remaining defendants. (Appellants' Opening Brief at 35-38). Consistent with Arizona waiver rules, this issue also falls under the settled rule that an "attempt to raise a federal question after judgment, upon a petition for rehearing, comes too late, unless the court actually entertains the question and decides it." *Herndon v. Georgia*, 295 U.S. 441, 443 (1935).

None of these waived "federal questions" seeking to challenge the verdict arose from a ruling of the Arizona Supreme Court which could not have been anticipated prior to the motion for rehearing. *Herndon, supra.*

Because no federal question was preserved below which questions the jury verdict, this Court is without jurisdiction to review its affirmance. 28 U.S.C. § 1257(3) (1982);[3] *Webb v. Webb*, 451 U.S. 493 (1981); *Herndon v. Georgia, supra; Murdock v. Memphis*, 87 U.S. (20 Wall.) 590 (1875).

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[3] This provision provides as follows:

Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows:

***

(3) By writ of certiorari, where the validity of a treaty or statute of the United States is drawn in question or where the validity of a State statute is drawn in question on the ground of its being repugnant to the Constitution, treaties or laws of the United States, or where any title, right, privilege or immunity is specially set up or claimed under the Constitution, treaties or statutes of, or commission held or authority exercised under, the United States.

Even if a federal question gave this Court jurisdiction of this case, these "federal questions" could not alter the verdict in any event since the waiver below is binding and constitutes an adequate state ground of decision. *Michigan v. Tyler*, 436 U.S. 499, 512 n. 7, (1978); *Cardinale v. Louisiana*, 394 U.S. 437 (1969).

Finally, even if not waived, the issues raised by Petitioners challenging the verdict fail to meet the criteria for granting certiorari and present no special and important reasons to grant the writ, as will be demonstrated. Sup. Ct. R. 17.

II. The Determination of Contract Liability Under Arizona Law Does Not Merit Review By This Court Under the Fourteenth Amendment.

Petitioners' theory that the trial court directed a verdict before the defendants presented their evidence is without basis in fact. The transcript confirms that the trial court's comments on the contract liability issues were simply to indicate the court's interpretation of the contractual documents; they did not constitute a directed verdict for the plaintiffs at the close of plaintiffs' case.[4] Defendants had moved for a directed verdict arguing that the master policy justified their termination of benefits. The court rejected this because it found that the contractual documents provided for *continuing* benefits. The trial court's ultimate directed verdict for plaintiffs on contract liability was granted *at the close of defendants' case*.

In its Opinion, the Arizona Supreme Court also held that Petitioners were liable under the insurance contract documents as a matter of law.

Petitioners admit that they did not seek leave to introduce *any* evidence on the "liability point already decided by the trial judge." (Petition at 10 n. 5). Under Arizona law defendants' failure to object to the supposed directed ver-

[4] The complete discussion in chambers on this question is set forth in the Appendix at 1a-4a.

dict prior to the close of their case or to make an offer of proof of that evidence which they would have sought to introduce on the question is a binding waiver of the objection. Ariz. R. of Evid. 103.[5] *See Montano v. Scottsdale Baptist Hospital, Inc.*, 119 Ariz. 448, 581 P.2d 682 (1978).

Petitioners finally assert that it was "only" because of the understanding of Suzanne Sparks of the insurance coverage that the Arizona Supreme Court reached its conclusion as to how an "ordinary person" would have understood the insurance. The only evidence Petitioners now claim they would have sought to introduce would not go to Mr. Sparks's insurance contract but, rather, only to what "ordinary" people would think the master policy means. (Petition at 10). Petitioners assert that the right which they allegedly lost, but never sought, was their right to have called a parade of lay people to testify as to how they would have interpreted the master contract.[6] The Opinion's discussion of how an ordinary person would have construed the insurance policy language was only illustrative of the court's legal conclusions as to the interpretation of the contractual language. The court obviously cited Suzanne Sparks' testimony only to exemplify this point. Given the

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[5] Rule 103 provides, in part, as follows:

(a) Effect of erroneous ruling. Error may not be predicated upon a ruling which admits or excludes evidence unless a substantial right of the party is affected, and

(1) Objection. In case the ruling is one admitting evidence, a timely objection or motion to strike appears of record, stating the specific ground of objection, if the specific ground was not apparent from the context; or

(2) Offer of proof. In case the ruling is one excluding evidence, the substance of the evidence was made known to the court by offer or was apparent from the context within which questions were asked.

[6] Defendants listed no such witnesses in their pretrial statement and thus waived their right to call them. Rule VI(a) of the Uniform Rules of Practice of the Superior Court of Arizona in part provides "[n]o other exhibits or witnesses shall be used during the trial other than those listed and exchanged, except for good cause shown."

fact that Calvin Sparks alone decided to purchase the insurance, debate among "ordinary" people as to the meaning of the master policy would have been irrelevant.

Under Arizona law, questions of contract interpretation are questions of law which are for the court to decide. *C & T Land & Development Co. v. Bushnell*, 106 Ariz. 21, 470 P.2d 102 (1970); *Kintner v. Wolfe*, 102 Ariz. 164, 426 P.2d 798 (1967). Thus, even if the court had ruled for plaintiffs on the issue of contract liability under the documents at the close of plaintiffs' case, such a ruling would have been correct or, at most, would constitute harmless error. Ariz. R. of Civ. P. 61.[7] Given the court's power to interpret contractual documents as a matter of law, and the uncontradicted evidence, any ruling by the trial court on the terms of the contract could be overturned by this Court only upon a finding that the trial court and Arizona Supreme Court misapplied and misinterpreted Arizona law.

III. No Constitutional Issues Arise From the Arizona Supreme Court's Affirmance of the Jury Instructions Given By the Trial Court.

A. The *Sparks* Jury Instructions On Bad Faith Did Not Deny Petitioners Due Process.

In a novel attempt to circumvent the law precluding review by this Court of state decisions based on matters exclusively concerning state law, Petitioners seek to have this Court review the Arizona Supreme Court's approval of the bad faith instruction under Arizona law on the basis

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[7] Rule 61 is identical to Rule 61 of the Federal Rules of Civil Procedure and provides as follows:

> No error in either the admission or the exclusion of evidence and no error or defect in any ruling or order or in anything done or omitted by the court or by any of the parties is ground for granting a new trial or for setting aside a verdict or for vacating, modifying or otherwise disturbing a judgment or order, unless refusal to take such action appears to the court inconsistent with substantial justice. The court at every stage of the proceeding must disregard any error or defect in the proceeding which does not affect the substantial rights of the parties.

that it was so arbitrary and capricious as to amount to a denial of due process. This issue was never preserved below nor was it even raised in the motion for rehearing.[8] This Court would be flooded with petitions for certiorari if it gave credence to Petitioners' novel claim. Disgruntled state court litigants could characterize every adverse state opinion as presenting such a "federal question."

In its Opinion, the Arizona Supreme Court carefully assessed the jury instructions and found that they were "adequate in informing the jury" as to the correct rule of law. 647 P.2d at 1136. In its Supplemental Opinion the court merely indicated that the specific language of the *Sparks* instructions should not be used as a model for future cases, but rather, that precise language from the intervening decision in *Noble v. National American, supra,* be included if properly requested. 647 P.2d at 1144.

The instructions were carefully reviewed twice by the Arizona Supreme Court and found to have been proper, even if not so perfect that future cases should use them verbatim. As such, the instructions adversely affected no substantial right of Petitioners' and, at most, constituted harmless error which would not justify reversal of the verdict. Ariz. R. of Civ. P. 61; *Palmer v. Hoffman,* 318 U.S. 109, 116 (1943). *See also, Alloy International Co. v. Hoover-NSK Bearing Co.,* 635 F.2d 1222 (7th Cir. 1980).

Petitioners assert that the *Sparks* Opinion somehow violates established Arizona retroactivity principles regarding common law decisions of the state's appellate courts. On the contrary, the court carefully weighed the instructions against the standards adopted in Noble, *supra* and found

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[8] Even a seemingly clear case of an arbitrary and capricious result by a state's highest court will not justify certiorari where the federal question was not preserved below. *See Estate of Wilson v. Aiken Indus., Inc.,* 439 U.S. 977 (1978) (Blackmun, J., concurring).

the instructions adequate in informing the jury as to the correct rules of law. Development of common law is a progressive process. The *Sparks* decision is merely a further refinement of the Arizona law of bad faith.

Petitioners for the first time now cast their argument in due process terms as the only way to even attempt to argue that this Court should review a question which is exclusively one of state law.

B. Affirmance of the Damage Award Was Proper Despite the Reversal as to Defendant Planned Security Trust.

Any issue regarding the constitutional implications of a reversal as to less than all defendants was also waived below since it was neither raised at the trial level nor before decision of the appeal. (Petition at 8 n. 4). Since Petitioners did raise the joint and several liability issue on appeal seeking reversal *as to one or more* of the defendants, it can hardly be said that the effect of a reversal as to less than all of the defendants on the damage award against the remaining defendants was so "unanticipated" as to require relief for Petitioners before this Court from their waiver of the issue. *Herndon v. Georgia, supra* at 443-444.

Petitioners' argument here is premised on *Washington Gas-Light Co. v. Lansden*, 172 U.S. 534 (1899), which is cited for the proposition that due process principles necessarily mandate reversal of a punitive damage award against joint tortfeasors when one of the tortfeasors is ultimately held not liable. The holding in *Washington Gas-Light Co.*, however, was decided as a matter of *common law* and not

as a principle of constitutional *due process.*[9] None of the subsequent cases citing *Washington Gas-Light* has referred to its holding as being premised on the due process clause.

Cases similar to *Washington Gas-Light* have reversed because the financial worth or nature of the tortious conduct of the improperly included defendant could have improperly impacted on the size of the punitive damage verdict against the remaining defendants. *Washington Gas-Light, supra; Landseidel v. Culeman,* 47 N.D. 275, 181 N.W. 593 (1921). Where there is no such effect, however, reversal is improper. *Constitution Publishing Co. v. Dale,* 164 F.2d 210 (5th Cir. 1947).

The "Agreement and Declaration of Trust" between defendant ALPHA and the First National Bank of Jackson, Mississippi, creating the "Planned Security Trust" (Appendix 5-A to 13-A) reveals that PST was a mere "dry trust" which could take *no* independent action of *any* significance without the express approval of ALPHA. PST was directed to obtain a policy from Republic only on terms specified by ALPHA (App. 5-A, Art. II, § 1). ALPHA totally indemnified the trustee from all liability and any such liability was to be solely that of ALPHA (App. 6-A, 7-A, Art. II, §§ 5, 6). ALPHA was to totally administer all aspects of the insurance and trust and the trustee was given no independent powers. (App. 7-A, Art. IV, § 1; App. 10-A,

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[9] *Washington Gas-Light* was brought in the Supreme Court of the District of Columbia, which at that time exercised the powers of both a local and federal court of original jurisdiction. Act of February 9, 1893, Chapter 74, 27 Stat. 434; Act of March 3, 1863, Chapter 91, 12 Stat. 762. The Court was "[e]ssentially a local court . . . which adjudicated controversies of the type generally addressed in the state courts." Voorhees, *The District of Columbia Courts: A Judicial Anomaly,* 29 Cath. U.L. Rev., 917, 924-925 (1980). The opinion of the Court of Appeals of the District of Columbia (reported at 9 App. D.C. 508), and the United States Supreme Court discuss common law principles and make no mention of constitutional due process.

Art. VIII, § 4) It is thus obvious that the trust was established only as a matter of convenience to hold the policy and that it had no independent legal significance apart from defendants ALPHA and Republic.

Appendix 14-A to 33-A quotes every reference to PST made in the presence of the jury; it confirms that the only discussion and evidence regarding PST was illustrative and foundational to an understanding of the insurance relationship between the Sparks family and defendants ALPHA and Republic. PST was simply "a mechanism" for the insurance and "incapable of exercising any control or taking part in any concerted action toward the plaintiffs." *Sparks*, 647 P.2d at 1138. There was *no* evidence or discussion of any financial worth or conduct of PST before the jury. Even if such evidence had been introduced, it would have been properly considered in determining damages against Republic and ALPHA, since ALPHA controlled the trust's assets and directed its conduct.[10]

The verdict against Alpha and Republic was proper since there is absolutely no basis for assuming the verdict was improperly influenced by the inclusion of PST.[11] The result in *Sparks* is consistent both with *Constitution Publishing, supra*, and prior Arizona case law affirming a joint punitive damage verdict against one defendant even though a codefendant obtained a reversal. *Rogers v. Bryan*, 82 Ariz. 143, 309 P.2d 773 (1957).

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[10] Respondents submit that the judgment against PST was proper because the trust was a legal entity which issued the policy in its own name. Acts of Republic and ALPHA on behalf of PST would therefore be a liability of the trust on joint venture or agency principles.

[11] Petitioners posit that the "assumption is inescapable that the jury roughly assessed one million dollars per defendant." (Petition at 14 n. 9). This assertion is wholly conjectural. If anything the conclusion is inescapable that the jury decided to award punitive damages in twice the amount of the compensatory damages.

For Petitioners to suggest that ALPHA and Republic should obtain a reversal because of the reversal as to PST is to suggest that Petitioners should escape a just verdict simply because they used the artifice of a trust as the conduit of their joint venture.

IV. Petitioners Were Not Denied Due Process of Law By the Court's *In Camera* Review of Respondents' Attorney Fee Agreement.

The *only* constitutional issue which was raised below concerned the trial court's award of $80,000 in attorneys' fees to Respondents. Respondents' request for statutory attorneys' fees pursuant to Arizona Revised Statute § 12-341.01 required a finding by the court that the amount of attorneys' fees awarded did "not exceed the amount paid or agreed to be paid." The court reviewed the fee agreement *in camera* and determined that the amount of attorneys' fees requested was in fact less than the statutory limit.

At the evidentiary hearing Petitioners were allowed to cross-examine Respondents' counsel to establish both that the fee agreement was contingent and that the potential percentage of the contingent fee exceeded the requested fees. The fact that counsel for Petitioners did not know the exact contingent percentage could have had no conceivable bearing on the question. The trial court's *in camera* inspection of the fee agreement posed no imaginable risk of error; Petitioner's examination of the fee agreement would have been of no additional value as a procedural safeguard.

Petitioners cite cases which held that the substantive use of evidence for rate-making purposes which was neither of record nor available to utilities denied them federal due process. *Ohio Bell Telephone Co. v. Public Utilities Commission*, 301 U.S. 292 (1937); *Interstate Commerce Commission v. Louisville and Nashville R.R. Co.*, 227 U.S. 88 (1913). In those cases the Court was particularly concerned that the evidence was not available to it, or any appellate court, so that it could "test the sufficiency of the facts that support the finding." *Louisville and Nashville,*

supra, 27 U.S. at 93. In this case, however, *the trial judge did not use the fee agreement as substantive evidence in determining the size of the award but only to ensure that the award did not exceed the limit set by the statute.* The amount of the court's fee award was to approximate an appropriate non-contingent fee determined from expert testimony and time records of Respondents' counsel. The fee agreement is under seal in the court file and is available for inspection by the appellate courts.

That the courts are the ultimate arbiters of privilege claims asserted against requests for production of documentary evidence is clear from *U.S. v. Nixon*, 418 U.S. 683 (1974). *In camera* review allows the court to measure a claim of privilege without first providing all material to the subpoenaing party. Utilizing *in camera* review, the court can protect the rights of all parties. Due process does not necessarily require independent review by the adverse party.[12] Disclosure of the actual fee agreement would have served no purpose in this case.

There is no special and important reason to review the attorneys' fees ruling, the only asserted constitutional issue raised and decided below. The issue meets none of the enumerated criteria for granting certiorari. Sup. Ct. R. 17.

CONCLUSION

The trial court, after verdict by jury, awarded a judgment based upon the contract between the parties and upon the outrageous and tortious conduct of the defendants. That judgment and verdict were based upon Arizona contract

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[12] Even in a criminal context, *in camera* inspection of privileged materials has been found proper as "a practice which is both reasonable and protective of defendant's rights." *United States v. Buckley*, 586 F.2d 498, 506 (5th Cir. 1978), *cert. denied*, 440 U.S. 982 (1979). A defendant's due process rights are not violated by a court's *in camera* review of non-substantive evidence, *United States v. Lyons*, 567 F.2d 777 (8th Cir. 1977), *cert. denied*, 435 U.S. 918 (1978); *United States v. Chacon*, 564 F.2d 1373 (9th Cir. 1977), even if the court hears testimony when the defendant is not present. *United States v. Lyons, supra.*

and tort law. The Arizona Supreme Court, the highest authority on Arizona law, upheld that judgment. Petitioners seek to have the decision reviewed once more by now alleging "federal issues" under the Fourteenth Amendment. Such "issues" are no more present in this case than in any state court adjudication in which motions were granted and jury instructions given. Such "issues" present no special and important reasons for review by this Court.

The Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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DATED: November 12, 1982

COMMENTS OF THE TRIAL COURT IN DENYING DEFENDANTS' MOTION FOR A DIRECTED VERDICT ON CONTRACT LIABILITY

(The following is excerpted from the proceedings held in chambers:)

THE COURT: I really want to know, for the purposes of my decision, what is Exhibit 1?

MR. HOLLAND: I'll get to that.

THE COURT: All right.

MR. HOLLAND: Let's narrow our sight, for the purpose of this argument and for the purpose of making this point, to the assumption that there was nothing more than Exhibit 1 in existence between the parties.

THE COURT: All right.

MR. HOLLAND: And that they were bringing suit on Exhibit 1. And that we were refusing to pay based upon an alleged termination of the contract.

The question would then be: Did the insured possess sufficient information at the time that the insuring representations were made and acted upon, and until the time of insurance effectiveness through the payment of benefits, and so forth occurred, did they possess sufficient information to know of the rights of termination which the insurance company reserved to itself.

THE COURT: All right.

MR. HOLLAND: My answer to that would be yes. Because we have—

THE COURT: I don't want the arguments why.

MR. HOLLAND: Yes.

THE COURT: Is it your position then that the plaintiffs were put on notice, by virtue of Exhibit 1, of the termination rights of your company, because obviously they couldn't have known through 14?

MR. HOLLAND: Absolutely. They were put on notice in that respect. And so far as Mrs. Sparks is concerned, she had the additional opportunity to read and examine the certificate of participation—

THE COURT: Okay.

MR. HOLLAND: —at the time that it was delivered.

THE COURT: *Well, if that's the case, then I'm going to have to rule against you on your motion for directed verdict.* I'm also going to have to make some law of the case, which is important to know where we are heading when the case resumes on Tuesday.

It's the position of the defendant and the plaintiffs that the plaintiffs relied on Exhibit 1, and that they could never be able to rely on Exhibit 14, because by then whenever Exhibit 14 could have been available, they were unable to comprehend it or the injury had already taken place.

I think we have an estoppel situation. I think Exhibit 1 is— (A), I don't think it's ambiguous at all. I think it clearly says to me that on its face that the obligation of the defendant for injuries runs beyond the termination of the contract until its limits are reached.

In other words, that my reading of the contract, and I see it as a matter of law, that right on that contract it says you get to have—once you're injured you continue with those benefits, even though the contract terminates.

But let's assume that I am not going to be limited to that ruling, because I also find that even if it's not a matter of law clear on its face, I find Exhibit 1 to be so ambiguous that I would have to rule against the insurance company in favor of the plaintiffs and find that again the obligation of the defendant for injuries to the plaintiff runs beyond the termination of the contract until the limits of the policy are reached.

I find that the plaintiffs' rights to receive benefits vest at the time of the injury, and continue on until the limits are exhausted. So, I find that those are two findings that I would make.

Beyond that, I believe that the plaintiffs have a right to reasonably expect—and in fact it shocks my conscience that the insurance company could possibly take any other view than once a person is injured under the terms of that policy that they cut off his injury rights just because he no longer is able to work and pay premiums. It doesn't seem to me that that's the purpose of health and accident insurance.

And I don't think that they have a right to limit themselves by the way they've tried to do in their position. But even beyond that, I think they have the—the plaintiff has the right to reasonably expect continuing benefits under the policy. I think the defendants are further estopped from their conduct, and from all the conduct that's been mentioned, to deny payments under this policy or to deny that the payments continue beyond the termination as claimed by the defendants.

Further, in view of the fact that the defendants are—I think they're further estopped because of the fact that they accepted money and continued on paying benefits during the term of the policy. I think that is—as a matter of law—is a decision that this Court has a right to make, and I so make it, removing from the jury those issues.

At this point I think the only thing that we can—I'll be glad to talk this over Tuesday, where we are going to head from here—is the question whether any issue should be submitted to the jury on the other factual theories that the plaintiff has brought forth: That is, consumer fraud,

fraud, intentional misrepresentation. I haven't made a decision on that yet, because it hasn't been argued. And also the argument as to whether the issue of bad faith and whether the issue of punitives should be issued to the jury.

MR. HOLLAND: In view of your ruling, as I respect it's been very clear in its giving, a very good indication of where the posture of the case stands in this Court, in view of the fact I believe you've used the expression "reasonable expectation" two or three times in your ruling, does this reflect your intention to invoke this doctrine of reasonable expectation, which the plaintiff has utilized in their arguments in this regard?

THE COURT: Yes. I would accept it in this jurisdiction. I would accept it as a good rule of law in this jurisdiction. But that is not the sole basis for my ruling.

MR. HOLLAND: I understand that. I wanted to clarify the record.

THE COURT: I think it's a unique—unique is the wrong word. I think it's a good theory to proceed under. But it's—beyond that, I think the face of Exhibit 1, right on itself, is so unambiguous as to clearly show coverage. And even if it is ambiguous, which it's the—if it isn't clear, then it's got to be ambiguous—it's got to be resolved against you.

So that, gentlemen, I'd do you the courtesy of letting you know what I believe the posture of the case is at that time.

Anything else?

MR. HOLLAND: No.

(An off the record discussion ensued.)

(R.T. "Ruling on Motions", August 29, 1980.) (Emphasis supplied).

* * * * *

PST-ALPHA TRUST AGREEMENT (EXHIBIT 15 IN EVIDENCE)

AGREEMENT AND DECLARATION OF TRUST

THIS AGREEMENT, made and entered into this 1st day of August 1975, by and between American Life Pension Health Associates Corporation (hereinafter ALPHA), Trustor, and First National Bank of Jackson, Mississippi, a national banking association, as Trustee;

WITNESSETH:

WHEREAS, ALPHA desires to establish a trust, the Trustee of which shall apply for and be the policyholder of such group insurance policy or policies as ALPHA directs for the benefit of employees of those employers who agree to become Trustors and participate in the Trust and accept a plan of group insurance as set forth herein and in such policy or policies, by executing and adopting said Request for Participation in substantially the form attached hereto as Exhibit A and made a part hereof;

NOW THEREFORE, in consideration of the premises and the mutual covenants herein contained, it is mutually agreed as follows:

ARTICLE I
NAME OF TRUST

The name of this trust shall be the Planned Security Trust.

ARTICLE II
POWERS AND DUTIES OF THE TRUSTEE

Section 1. The Trustee shall make application to Republic National Life Insurance Company, Dallas, Texas, (hereinafter the Insurer) for the issuance of a policy or policies, or riders thereto, of Group Insurance to be issued to the Trustee as policyholder, providing such benefits for employees of participating employers and containing such other terms, all as directed in writing by ALPHA.

The Trustee shall agree with the Insurer regarding the above policy or policies of insurance on matters such as waiting period, conditions of eligibility, and any other conditions, all as directed by ALPHA.

Section 2. The Trustee shall exercise all rights and privileges granted to the policyholder by the provisions of the insurance policy or policies and may take any action with respect to such policy or policies of insurance, provided, however, Trustee shall not enter into any agreement with the insurer with respect to any alteration, modification, or amendment of such policy or policies except as directed in writing by ALPHA.

Section 3. The Trustee shall notify ALPHA of any tax or assessment levied upon the Trustee by reason of the existence of this trust.

Section 4. The Trustee need take no action to apply for any policy of insurance or to exercise any rights or privileges which the Trustee may have as a holder of an insurance policy pursuant to this agreement or to collect, receive, or disburse any funds or assets of any kind which may come into its possession pursuant to this agreement except on the written direction of ALPHA signed by an authorized representative thereof. Any action done or omitted by the Trustee in reliance on a written direction of ALPHA reasonably believed by the Trustee to be genuine shall be conclusively presumed to be proper for the discharge of the Trustee's duty pursuant to this Agreement. ALPHA shall indemnify the Trustee for any loss which it may sustain by reason of any action taken or omitted in reliance on a written direction of ALPHA.

Section 5. The Trustee shall have the right to require such information from ALPHA as the Trustee deems useful or necessary to discharge its duties under this Trust Agreement. The Trustee shall not be required to determine the accuracy or sufficiency of any information received from ALPHA. The Trustee shall not be required to determine the accuracy of computations of ALPHA to be used in de-

termining the number of participants for whom premiums are to be paid and the classification of such premiums. The Trustee shall not be required to maintain records concerning any participant in said insurance plan. The Trustee shall not be obliged to commence or maintain any litigation with respect to the trust unless it shall have been indemnified to its satisfaction against all expenses and liabilities that may be incurred thereby, including reasonable attorney's fees.

Section 6. The Trustee shall act in good faith and with ordinary care and so long as it does so it shall incur no responsibility, liability or obligation for loss or damage to any person as a result of any action taken or any act omitted to be taken by it or by any of its agents or employees. The Trustee is hereby authorized to rely upon the advice of ALPHA in the exercise of any right or privilege granted to it as a policyholder under the Group Insurance Policy or Policies and in the exercise of its duties as Trustee under this Agreement, and shall become liable to no person by reason of following such advice.

ARTICLE III
COMPENSATION AND EXPENSES OF TRUSTEE

Section 1. The Trustee shall be entitled to a reasonable compensation for its services, as may from time to time be agreed upon by the Trustee, and ALPHA shall be responsible for the payment of such fees.

Section 2. The Trustee shall be reimbursed for all taxes and assessments incurred in connection with this trust.

ARTICLE IV
ADMINISTRATOR

Section 1. ALPHA shall have the duty to administer this Agreement, and shall bear all expenses in connection therewith except for the contributions required by the Employers and employees hereunder. ALPHA shall construe this Agreement and determine all questions of interpretation, policy or administration of this Agreement

and the Plans of the Employers, and may correct any defect, supply any omission or reconcile any inconsistency in such manner and to such extent as it shall deem necessary or advisable to carry out the purposes hereof.

Section 2. ALPHA shall have the right to delegate the duty of administration imposed upon it under Section 1 of the Trust Agreement provided it joins Trustee as a party to any agreement by which it delegates its duty of administration.

ARTICLE V
RESIGNATION, REMOVAL AND SUBSTITUTION

Section 1. The Trustee shall have the right to resign at any time by delivering to ALPHA a written notice to take effect not less than 60 days after delivery thereof, unless ALPHA shall accept as adequate, a shorter notice.

Section 2. ALPHA shall have the right to remove the Trustee at any time by delivering to the Trustee a written notice to take effect not less than 60 days after delivery thereof unless the Trustee shall accept as adequate, a shorter notice.

Section 3. Upon resignation or removal of a Trustee, ALPHA shall appoint a successor Trustee which will have all the powers and duties of the predecessor Trustee.

Section 4. The Trustee, upon resigning or being removed, shall assign, transfer, convey and deliver to the successor Trustee or other person designated by ALPHA of all of its right, title and interest in and to the hereinbefore described Group Insurance Policy or Policies, and thereupon shall be fully released and discharged from all further obligations and liabilities hereunder, and the said successor Trustee shall succeed to and be vested with all of the powers, rights, discretions, obligations, and immunities conferred upon the original Trustee.

Section 5. The Trustee resigning or being removed shall have the right to settlement of its accounts, and upon failure of ALPHA to agree thereon, may apply to a court of competent jurisdiction or adjudication.

Section 6. Any successor to First National Bank of Jackson, Mississippi or American Life Pension Health Associates Corporation, whether through sale of transfer of its business, conversion, consolidation, merger, or otherwise, shall forthwith become the successor Trustee or successor to ALPHA respectively hereunder and shall succeed to all right, title and interest of the Trustee or ALPHA hereunder, and all powers, rights, discretions, obligations, and immunities of the Trustee or ALPHA hereunder, with the same effect as though such successor were originally named herein as the Trustee or ALPHA.

ARTICLE VI
TERMINATION OF TRUST

This trust may be terminated by ALPHA, the effective date of such termination to be the end of the policy month under the policy or policies purchased hereunder which next follows by at least ten days the receipt by the Trustee of notice of termination.

ARTICLE VII
AMENDMENTS

The provisions of this trust may be amended at any time by an instrument executed by ALPHA and the Trustee, provided that no amendment shall alter the purpose of the trust, to-wit: to provide through the trust hereby created insurance benefits as referred to above, and provided further that no such amendment shall increase the duties or decrease the powers of the Trustee without its written consent. ALPHA shall immediately notify the Insurer of any amendment or amendments to this agreement and shall forthwith furnish the Insurer with a properly executed copy of any such amendment or amendments.

ARTICLE VIII
MISCELLANEOUS PROVISIONS

Section 1. No person, partnership, corporation or association dealing with the Trustee shall be obligated to see that the terms of the trust have been complied with, or be obliged to inquire into the necessity or expediency of any act of the Trustee, and every instrument effected by the Trustee shall be conclusive in favor of any person, partnership, corporation or association relying thereon that:

(a) At the time of the delivery of said instrument, the trust was in full force and effect;

(b) Said instrument was effected in accordance with the terms and conditions of this Agreement;

(c) The Trustee was duly authorized and empowered to execute such Agreement.

Section 2. Any right to insurance benefits of any employee of a participating employer or any person claiming by, through or under such participant shall exist only to the extent that such benefits are provided under the terms and provisions of any policy or policies purchased hereunder.

The Trustee shall incur no liability, obligation or responsibility for any action taken pursuant to said written certification received from ALPHA.

Section 3. This Agreement shall extend to and be binding upon the successors and assigns of ALPHA and the Trustee.

Section 4. ALPHA shall construe this Agreement and determine all questions of interpretation, policy or administration of this Agreement and the Plans of the Employers, and may correct any defect, supply any omission or reconcile any inconsistency in such manner and to such extent as it shall deem necessary or advisable to carry out the purposes hereof.

ARTICLE IX
SITUS AND CONSTRUCTION OF TRUST

This trust is created and accepted in the State of Mississippi and all questions pertaining to its validity or construction shall be determined in accordance with the laws of that State.

In the event that any portion of this Agreement shall be construed by any court of competent jurisdiction to be illegal or unenforceable, said decree shall affect only such provisions as are referred to and all of the other provisions in said Agreement shall be enforceable as to each of the parties hereto.

For the purpose of complying with any federal or state registration or disclosure statutes concerning member trusts, ALPHA shall be deemed to be the Plan Administrator hereof in lieu of the Trustee.

IN WITNESS WHEREOF, the Trustee and ALPHA have caused this Agreement to be executed by their respective officers thereunto duly authorized on the date first above written.

AMERICAN LIFE PENSION
HEALTH ASSOCIATES
CORPORATION

By /s/ _____

Attest: /s/ _____

FIRST NATIONAL BANK OF
JACKSON, MISSISSIPPI

By /s/ _____

Attest: /s/ _____

EXHIBIT A

REQUEST FOR PARTICIPATION IN PLANNED SECURITY TRUST

The undersigned Employer adopts and requests to become a trustor and participate in all of the terms and conditions of the Agreement and Declaration of Trust made and entered into as of August 1, 1975 by and between the American Life Pension Health Associates Corporation and the Trustee of the PLANNED SECURITY TRUST.

It is understood that under the provisions of the Agreement and Declaration of Trust, Participating Employers shall contribute to the PLANNED SECURITY TRUST an appropriate initial contribution and such other amounts as may be required for the purpose of providing and maintaining a plan of group insurance as specified in said Agreement and Declaration of Trust and that Participating Employers shall furnish any information required in the administration of said insurance trust.

It is also understood that should the undersigned or any or all of his employees, for any reason, fail to qualify for insurance as provided in said Agreement and Declaration of Trust and the insurance policy or policies issued thereunder, any monies paid by or on account of the undersigned for the purpose of providing and maintaining insurance as specified in said Agreement and Declaration of Trust shall be returned to the extent of such lack of qualification and there shall be no further obligation whatsoever on the part of the Trustee in connection therewith.

Dated at Phoenix, Arizona this 7th day of July, 1975.

Attest American Life Pension Health Associates Corporation
(Full Name of Employer)

/s/
(Signature)

Chairman of the Board
(Title)

QUOTATIONS OF ALL REFERENCES IN TRANSCRIPT TO DEFENDANT PLANNED SECURITY TRUST MADE IN THE PRESENCE OF THE JURY[1]

Now, I imagine you've already been able to gather pretty much from what Judge Marquardt told you during the voir dire that basically this lawsuit involves a claim by my clients, Calvin and Suzanne Sparks, against the defendants in this case, the Republic National Life Insurance, the American Life Pension Health Associates Corporation, Alpha Corporation, and Planned Security Trust, or the Plan, dba Planned Security Trust.

(Plaintiffs' Opening Statement, R.T. I, at 16.)

Q Okay. Would you describe those documents?

A The one identified as Number 14 is a document headed "Planned Security Trust, participating unit, Sun Valley Sales Air Conditioning, insured Murray C. Ostrander."

***

Q Is the schedule of benefits similar to that typically given to each insured of an insurance group of the Planned Security Trust?

A I don't know.

Q Okay. Aside from the first page of that document, what are the remaining pages of Exhibit 14?

A Photocopies of what appears to be a group insurance certificate of Republic National Life. The reason I said I couldn't identify it is that we have, you know, a whole

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[1] Statements where the name Planned Security Trust or "PST" were merely mentioned, with no explanation as to what Planned Security Trust was or how it interacted with the other defendants, have been omitted.

bunch of different groups, and I'm not familiar enough with PST to tell whether this is one of theirs or not. This is the kind of document we would give to a group certificate holder. I don't know if it's one of ours or not, in its entirety.

(Cross-examination of Boyd Croxen, R.T. I at 68-69.)

Q I see. And would this be a document typically given to an insured group under a trust such as the Planned Security Trust?

A No.

(Id. at 69-70.)

Q You've been employed by Republic National Life since 1975?

A But I don't know what if that document there is one that would be given to an insured under PST.

(Id. at 70.)

Q Okay. Has the printed part, aside from that insert, been in use by the company for several years?

A This is a document produced and prepared by *Planned Security Trust, which is an organization of the ALPHA group.* I've seen this document—or not this one—but I've seen another one just like it several times, in the course of my work as an assistant counsel.

(Id. at 71.) (Emphasis supplied.)

Q Would you describe the relationship between Republic National Life and the Planned Security Trust and ALPHA?

A All right. Republic National Life Insurance Company is an insurance company. It's a stock, life and health insurance company, domiciled in Dallas, Texas. It does business in all the states of the United States, with the exception of New York.

We issued some years ago—and it was before I worked for the company, so I'm not exactly sure when. *But we issued a group insurance policy to an entity known as the Planned Security Trust. That's a trust established in a bank in Jackson, Mississippi.*

Under that group insurance policy ALPHA Corporation, or American Life Health Pension Associates, administers and markets a program of group insurance for mostly small employers, people who have generally less than 25 employees.

ALPHA Corporation, through brokers or insurance—insurance salespeople all over the country, sells coverage to an employer such as Mr. Sparks' company, insuring the people who work for that company. They also administer the insurance. That is they collect the premium from the unit, which is this document Number 14. It says participating units, Sun Valley Sales.

The employers are called units. The individuals who are insured as employees of Sun Valley Sales are insurers. Group insurance similar to the group insurance that anyone has who works for an employer—I'm a group insurer of the Republic National Life Employee Group.

In addition to selling through its licensed agents all over the United States, who are also licensed with the Republic, the insurance—ALPHA administers it by collecting the premium by billing—for sending a bill to the unit for the amount of insurance or the number of persons they think are insured; sending past due notices and all that sort of stuff.

They also are the primary claims handling people. Now, this is ALPHA Corporation. The claim is typically sent to them. Their claims or processing people evaluate the claim, determine what amounts are payable under the policy for the particular benefits claimed, and prepare a draft drawn on our accounts and pay the claims.

(Id. at 71-73.)

Q Would Republic National Life typically send any document whatsoever to an individual group insured of the Planned Security Trust?

A No.

(Id. at 74.)

[Q] Let's take Calvin Sparks. What would he get from Republic National Life?

A He should get a certificate of insurance.

Q A certificate in the fashion that's marked as Exhibit 13?

A We have been there—

Q In the same format?

A I, you know—I don't want to be difficult about this. This is like the certificates of insurance that my company uses. I just don't know if that's the certificate from PST.

Q In any event, Mr. Sparks as an individual insured of the Planned Security Trust, would receive a document that explained the terms of the Republic National policy, would he not?

A He should receive a document which is in most respects a copy of the policy Republic issued to the Planned Security Trust in Jackson, Mississippi.

(Id. at 75.)

Q To your knowledge, is there any difference in the certificate sent to an individual insured of the Planned Security Trust, and the policy directly of the Planned Security Trust?

A Yes, there are differences.

Q Okay. Would there—

A But there is two different documents.

(Id. at 76.)

Q To your knowledge is there any difference in terms of the insuring provisions that would cover a given individual between the certificate or a policy, that you received from Planned Security Trust and the policy issued by Republic directly to Planned Security Trust?

A In very broad terms, no.

Q Okay. So, in using those same broad terms, basically the insuring provisions issued from Republic National to Planned Security Trust are the same as from Planned Security Trust to the individual insured?

***

THE WITNESS: No.

BY MR. BURNHAM:

Q Do you have in your possession a copy of the policy of insurance issued to the Planned Security Trust by Republic National, with you today?

A No, I didn't bring one.

Q Do you have a copy of the form of certificate that would be issued by Planned Security Trust to an individual insured?

A No. I think we produced that earlier for you.

(Id. at 77-79)

Q Let me ask you some other general questions about the Planned Security Trust.

From 1977 to present, do you have any knowledge as to how many states in the United States that trust is qualified to solicit insurance with?

A No, I don't.

Q Do you know of your own personal knowledge whether any insured of the Planned Security Trust covered by the Republic National Life policy ever received a $250,000 benefit payment by that company?

A No, I don't.

(Id. at 81-82.)

Q As to the Planned Security Trust transaction, are you aware—

A Of something Republic National Life does?

Q Right. To your knowledge, would Republic National Life send any document to an insured under the Planned Security Trust?

A Not directly.

Q Okay. Indirectly, how would it work? Was Planned Security Trust to send some document of Republic National Life to its insurers?

A I don't understand that question.

Q How, indirectly, does Republic National Life transmit?

A To the extent that ALPHA Corporation is an agent of Republic National Life, and ALPHA distributes information to insurers. Then Republic would, as the principal of the agent. Republic doesn't send anything to those people directly.

Q Okay. To your knowledge was there any policy or agreement of Republic National to have a certificate sent by ALPHA to each insured of the Planned Security Trust?

A Yes, there is such an agreement.

Q Okay. Does that certificate, if you will, sent to each insured, typically follow the issuance of the policy to the individual insured, or is it simultaneous with the transaction? Strike that.

In other words, a person signs up for coverage under the Planned Security Trust; at what point does he get the certificate from Republic National? At some later time?

A Well, yeah. Obviously we don't, now. There are 240 million people out there, and Republic has 4,000 agents, and we don't receive mental telepathy to know.

Q So typically, when an agreement is entered into whereby an insured group buys the Republic National or Planned Security Trust policy, they've never seen a more detailed description of its benefits and provisions than a document such as Exhibit 1? Is that not correct?

A Well, I'm not going to say they never have. I don't know.

Q Well, in a typical case?

A I don't know.

Q Aside from a certificate or brochure of that nature, are you aware of any other documents that an insured of the Planned Security Trust would typically receive?

A Sun Valley Sales should have a participation agreement. The documentation evidencing insurance for Sun Valley Sales and its employees should consist of a participation agreement by the employer, whereby the employer company agrees to participate in the trust, and certificates of insurance issued by ALPHA Corporation as the administrator for each individual, or individual and family group—I don't want to use the word "group"—for each individual or individual and family insured under the unit.

(Id. at 86-88.)

Q Okay. You refer to a participation agreement as being an agreement entered into by, for example, Sun Valley Sales and the Planned Security Trust?

A Yes.

Q Would that document be received by Sun Valley Sales typically after the effective date of the insurance?

A As I recall, that's a document that Sun Valley Sales signs, which goes to ALPHA Corporation as the administrator of the trust. I don't think it's something that Sun Valley Sales gets to keep, unless there is some provision for them to have a copy of it. It doesn't evidence any insurance coverage.

(Id. at 89.)

Q Okay. In what circumstances does Republic National Life terminate an insured group under the Planned Security Trust?

A Well, Republic National Life can terminate its insurance of the Planned Security Trust by giving notice, according to the contract.

Q In what circumstances can the Planned Security Trust terminate an insured group?

MR. HOLLAND: I object, Your Honor, because we still don't have anything that indicates that Republic National Life Insurance Company controls the termination of contracts made by PST with individual groups such as Sun Valley Sales.

Mr. Croxen's expertise and knowledge is solely limited by the testimony, at least that we have heard, to Republic National Life Insurance Company and its dealings with PST, rather than PST's dealings with individual insurers.

THE COURT: Perhaps that ought to be asked, if his knowledge only goes to Republic, and not to any subsidiary. Then we ought to get that as the foundational question first. If he can't testify to a subsidiary, then I'll sustain.

MR. BURNHAM: Mr. Croxen, do you have any familiarity with—

MR. HOLLAND: May I ask that your remarks be stricken from the jury, because you just referred to PST as a subsidiary, which Mr. Croxen has not indicated in his testimony.

THE COURT: You're absolutely correct. I'm not attempting—I don't want to use that word. I haven't heard the relationship.

MR. HOLLAND: I feel very sensitive, because we tried to define, and I don't want—

THE COURT: I thank you, and stand corrected.

I hope you understand, ladies and gentlemen, I'm not trying to set up the roles and relationships.

BY MR. BURNHAM:

Q Do you have any—do you, yourself have any knowledge as to what the terms of the insurance issued by the Planned Security Trust were or are to the insured? Have you reviewed the certificates they've made?

A In general terms I know.

Q Okay. I think you've testified that Republic National sees to it that its owners, if you will, go from Republic National to ALPHA, through the Planned Security Trust, and to the individual insured, isn't that correct?

A No, I didn't testify to that. I said ALPHA issues certificates of insurance under a group insurance policy issued by Republic National Life.

Q And is the ALPHA certificate of insurance a Republic National Life form agreement?

A Yes.

Q Okay. Under what—and are you familiar with—basically with what form of Republic National Life agreement was used by ALPHA under the Planned Security Trust?

A It's some component of what we call the 3,000 group series policies and group certificates. There are 164 pages that can be used to create a single policy under that series. And I have no idea what combination is PST.

(Id. at 91-93.)

Q Okay. Are the termination practices of ALPHA or PST, to your knowledge, any different than what the policy provisions say?

A Not to my knowledge. They should not be.

(Id. at 95.)

Q There never was any policy issued to Sun Valley Sales?

A There never was any policy issued to any unit under the Planned Security Trust.

Q Okay. The policy was issued to the employees, is that correct?

A No, sir. The policy was issued to the Planned Security Trust by Republic National Life Insurance Company.

Q Okay.

A The individual insured or individual insured and their families get a certificate of insurance evidencing the coverage they have chosen to purchase under the policy issued to Planned Security Trust.

I—you know, I'm sorry to sound so complicated. I'm sorry I don't respond when you don't ask in my words, but I have to do it that way.

Q All right. The certificate the individual gets describes the provisions of the policy to the Planned Security Trust?

A That's correct.

Q Okay. So, for all practical purposes the individual insured has a document of the nature that's marked as Exhibit Number 14?

A It should be something like this one. That's right.

Q So then, when we refer to "termination" the individual would be terminated by the Planned Security Trust or by Republic National Life?

A More likely it would be because of his dealings with the Trust or more—I'm sorry that's not correct.

More likely it would be because and through his dealings with ALPHA Corporation. *The trust—the trust is just a trust in the bank. It holds the policy. It doesn't do anything.*

Q Okay. So ALPHA Corporation makes a decision to terminate a given individual?

A In accordance with the policy.

Q Okay. And is governed by the terms of the policy?

A. Yes.

(Id. at 97-98.) (Emphasis supplied.)

Q Okay. Now, based upon your knowledge of the Planned Security Trust, ALPHA Corporation certificate, the master policy, and Republic National Life Company, after culmination of the policy what is the consequences of termination of the policy to a given individual's medical treatment or eligibility therefor?

A Coverage terminates.

Q Totally?

A Yes.

Q Okay. So, if we will—if the policy terminates on today, and a person goes into the hospital for treatment tomorrow, would that be covered or not covered, or paid for?

A By Republic National Life?

Q Yes. With the Planned Security Trust or ALPHA Corporation.

MR. HOLLAND: I object to the lack of foundation about what's covered by PST. Mr. Croxen here again is talking about a policy—master policy which has variables in it that are reduced to a specific plan that is then sold according to the negotiations between PST, through ALPHA Corporation, and the consumer or the customer.

And the master policy, as he's testified, covers all these 164 page variables. And therefore, until we know specifically which provisions are being covered, it's a question that's improper for this witness to answer. And then when it is refined on that point, the policy speaks for itself.

(Id. at 99-100.)

Q This second page—the third page of the brochure talks about PST Plus, major medical benefits. Did Calvin purchase that coverage?

A No, sir.

(Direct examination of Robert Bowden, R.T. II at 77.)

Q And prior to selling this coverage to Calvin, this PST policy, have you had any prior course of dealings with PST and ALPHA?

A Well, yes, I had one other. I had one other policy with them, in a sense. I had several of them.

Q With both ALPHA and PST?

A *Well, ALPHA, sir, is PST.*

(Redirect examination of Robert Bowden, id at 86.) (Emphasis supplied.)

Q Very good. Now, turning over to the next document here, can you tell me what this is?

A This is the trust document for the Planned Security Trust.

Q Okay. And turning over—this has several pages—can you tell me who signed that document?

A It was signed by myself and Mr. Wardlaw (phonetic) who's the trustee of the First National Bank, Jackson, Mississippi.

Q Did you sign that document as chairman of the board—

A Right.

Q —of ALPHA?

A Yes, sir.

Q What does this document signify?

A This simply is a trust instrument, which all of these policies and groups were insured under.

Q I see. Was this prepared in the normal course of bussiness [sic] at ALPHA Corporation?

A Yes sir.

Q Let's turn—this next document—what is that? Is that part of the same document or—

A Yes, this is part of the same trust document.

Q Okay. And whose signature appears on that?

A My signature.

Q And again, as chairman of the board of ALPHA?

A Yes, sir.

(Direct examination of James Bundy, Chairman of the Board of the ALPHA Corporation, R.T., IV at 4-5.)

Q Mr. Bundy, were you at any time during the period of 1975, through the first of May, 1977, an officer of Planned Security Trust?

A No, sir. There were no officers of Planned Security.

Q Did you have any official capacity in relation to Planned Security Trust?

A No, sir.

Q Thank you. That was an entity that your company contracted with, did I understand, is that correct?

A Right.

Q Did you have custody of any of the documents that were the property of Planned Security Trust during that period of time?

A No. The trust document and the master policy were held by the trustee, who was First National Bank of Jackson, Mississippi.

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Q Yes. We have three parties. If there was a contract made between Republic National Life Insurance Company and Planned Security Trust, in January, 1977, did you have any participation in that yourself?

A *I would participate from the standpoint of working with Republic National, to design the product. But Republic National would issue the policy—the master policy to the Planned Security Trust.*

(Id. at 9-10.) (Emphasis supplied.)

[Q] Did ALPHA corporation ever co-sign or otherwise bind itself to this master policy, as far as you know?

A No, sir. Master policy is issued to the trust. And ALPHA does—that's a trustee in Mississippi.

(Id. at 11-12.)

Q What you said earlier, I believe, that this is not part of the documentation that—that ALPHA Corporation participated in itself, is that correct?

A *Right. Master policy is issued to the trustee, which is the bank. We have—or ALPHA Corporation has a copy of the master contract, and they're instructed to administer and pay benefits according to what coverage the people have under the master contract.*

(Id. at 14.)

[Q] The trust which we have been talking about was created on August 1, 1975, was it not?

A Yes, sir.

Q *Okay. Now ALPHA, pursuant to these agreements—ALPHA was the administrator of Republic National's policy which was issued to the Planned Security Trust, and that's been the case since August 1, 1975, isn't that true?*

A *Yes, sir.*

Q As such, ALPHA has had the power, as given them by Republic National, to approve and deny claims under the policy since that time, isn't that true?

A Right. ALPHA would administrate, according to the direction from Republic National. However, if a claim came up—[illegible]lly claims, I believe, over $5,000—any of those claims—or maybe it was $2,000, $2,000 or $5,000—any claim in excess of that we would send to Republic National, and then they would process the claim.

(Id. at 19-20.) (Emphasis supplied)

Q Okay. Did ALPHA, as the administrator, have occasion to prepare advertising literature concerning the policies that Republic National was underwriting?

A Right. ALPHA would prepare brochures and certain advertising literature, but it was with the understanding that all of it had to be approved prior to release by Republic National.

Q So, any literature would have to be approved by Republic National before it would be distributed?

A Yes, sir.

Q Would you look at Plaintiff's Exhibit 1 in evidence, and tell me if you've ever seen a document like that before?

A Yes, sir. This is Planned Security Trust brochure.

Q And would that—what you've just testified to, did it apply to that brochure? In other words, would ALPHA distribute a brochure of that nature without first obtaining the permission of Republic National?

A No, sir.

Q Are you aware, sir, whether or not there is any differences between this brochure concerning the major medical coverages and the brochure that ALPHA was distributing to its agents in the year 1977?

A The date in this is 5-78, and it's got a number 4 on it. This means, I believe, it's the fourth reprint. And approximately every nine months we would reprint the brochures and make any necessary changes that—typographical errors, or anything that Republic National felt needed to be changed. I do not know if this was—this date of 5-78—I would assume in 1977 there was another brochure.

(Id. 21-22.)

The insurer in this instance is called Planned Security Trust. Planned Security Trust is according to the evidence, we believe, a trust in a bank in Mississippi which exists on a set of legal sized sheets of paper which has among its assets money which it used to receive premium, disburse benefits in the line of insurance. It has no agents. It has no employees that you'll hear about in the context of dealing with Sparks.

There will be no testimony directly or indirectly linking Planned Security Trust to anybody in this action save and except that it was their, it was Planned Security Trust's money which was used in the taking of the insurance application and the disbursement of benefits.

Also, there will be Republic National Life Insurance Company referred to. If you're interested in geography, you can imagine first of all that Alpha Corporation is in Baton Rouge, Louisiana down to the Gulf of Mexico in the State of Louisiana. As we have mentioned, Planned Security Trust is in a bank in Mississippi.

Republic National Life Insurance Company as you have heard or will hear is one of the large insurance companies in the United States. They underwrite insurance for other companies in addition to doing certain insurance work of their own. In this instance, they are referred to as the underwriter. That is to say they insure the business which is being transacted by Alpha Corporation for Planned Security Trust and certain responsibility for the payment of claims comes and falls upon Republic National Life Insurance Company. For lack of a better word, they would be the insurance company for the initial insured.

(Defendants' Opening Statement, R.T., V at 28-29.) (Emphasis supplied.)

Mr. Bowden, we believe the evidence will develop will be regarded as an agent under the insurance laws of Arizona. You'll be told what those laws require. We'll not talk about it here but the proof will be to the effect that Mr. Bowden in his relationships was not employed by Republic National Life Insurance Company. He was not employed by Alpha Corporation. He was not employed by Planned Security Trust.

(Id. at 30.)

Q *Mr. Kelly, what does Republic National Life get out of this relationship with the Planned Security Trust and Alpha Corporation?*

A *Republic National Life is the insurer, any type of profit that would be made on the insurance Republic would get.*

Q *And that is the insurance with the trust?*

A *Yes.*

(Cross-examination of Hunter Kelly, id. at 48.) (Emphasis supplied.)

Q Let me ask you with respect to Planned Security Trust. Do you have any communications with Planned Security Trust with respect to what you do in dealing with these claims or continuation of business in force on any of those groups?

A *Planned Security Trust does not exist other than as a document, as a mechanism for insurance. There are no, there is not an office of Planned Security Trust. There are no people at Planned Security Trust. It is strictly an insuring mechanism.*

(Direct examination of Robert DeArmond, id. at 84-85.) (Emphasis supplied.)

In addition to that, my client is Planned Security Trust. I have never met Planned Security Trust, I can't ever meet Planned Security Trust because it is only a set of documents in the bank in Jackson, Mississippi. That has been testified to without contradiction may times.

(Defendants Closing Argument, R.T. VII, at 28.) (Emphasis supplied.)

As I've said, Planned Security Trust had nobody doing anything, they just are represented by documents, by money in the bank and hopefully by making a profit and participating in insurance transactions of the kind that have been discussed here.

(Id. at 29.) (Emphasis supplied.)

The fact that Mr. Kelly doesn't know anything about that, ladies and gentlemen, doesn't prove anything because you see the defendants in this case are the Alpha Corporation, the Planned Security Trust, this paper organization, and Republic National Life Insurance. We are not suing Hunter Kelly, we're not suing Mr. DeArmond, we're not

suring [sic] Boyd Croxen, we don't have to prove that Boyd Croxen had some ill will in his heart for the Sparks to prove our case.

We're suing the companies, not the individuals in the company. The fact that Mr. Hunter Kelly has no knowledge of this lawsuit until three months ago is irrelevant. His company has known about it all along, they had known about it.

The point is, ladies and gentlemen, you can't allow these defendants to try to hide behind each other and say well, like Mr. Kelly says, the paper, the Planned Security Trust is just a paper agreement that is sitting in a bank somewhere, there is no people to represent that, it's just a paper entity. You can imagine what the Sparks have had to go through in dealing with these people with these kinds of explanations. He tells us that, you know, the Planned Security Trust could not have done anything because it's just a paper document.

Well, the fact of the matter is that Judge Marquardt is going to tell you in his instructions that this is a direct quote, I have determined that Republic, PST and Alpha Corporation were acting jointly and severally in selling the insurance, circulating literature concerning it, and in deciding whether or not to pay claims under it.

That simply means, ladies and gentlemen, that you cannot have big companies like Republic National Life Insurance Company and the Alpha Corporation getting together and creating some entity on paper, filing it away in the bank and then saying that we didn't do anything wroing, how could this paper do anything wrong, it's just paper.

The fact of the matter is the paper functions according to the way the companies want it to function and Judge Marquardt has already ruled that Alpha Corporation, Planned Security Trust and Republic National Life Insurance Company are all responsible for each other's actions and you

have to look at them in terms of companies because one man in any one of those companies doesn't feel any ill will for the Sparks or doesn't know about this or doesn't know about that does not mean that the entire company is now suddenly free of any wrongdoing.

(Plaintiffs' Rebuttal Closing Argument, id. at 58-60.)

No. 82-645

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IN THE

Supreme Court of the United States

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REPUBLIC NATIONAL LIFE INSURANCE COMPANY

and

AMERICAN LIFE PENSION HEALTH ASSOCIATES, INC.,
Petitioners,

v.

CALVIN C. SPARKS AND SUZANNE SPARKS,
Respondents.

REPLY BRIEF

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REPLY BRIEF

A short reply to Respondents' Brief in Opposition to Petition for a Writ of Certiorari (hereinafter "Opposition") is warranted.

1. Respondents contend that the Petitioners failed to challenge the trial court's *sua sponte* grant of a directed verdict and erroneous jury instructions at the trial level or in appellate briefs before the Arizona Supreme Court, and that those issues may not now be reviewed in this Court. (Opposition at 7-8).[1]

Respondents are in error. The record shows that Petitioners challenged the trial court's *sua sponte* grant of directed verdict and erroneous jury instruction on bad faith

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[1] Respondents concede that they may raise no such objection to Petitioners' challenge to the trial court's *in camera* review of documentary evidence which Petitioners and their counsel were forbidden to see. (*Id.* at 7).

at *both* the trial and appellate levels. (*See* Petition at 4 & n.2, 5). Of course, it was not possible to challenge the opinion of the Arizona Supreme Court in denying rehearing, and it was only in that brief opinion that the Arizona Supreme Court both disapproved the jury instructions and refused to disturb the judgment based thereon. The record further shows that Petitioners challenged the Arizona Supreme Court's unforeseeable dismissal of defendant Planned Security Trust (PST) and simultaneous affirmance of the lump sum damage award on motion for rehearing, *i.e.*, at the earliest possible juncture in the proceedings. (*See* Petition at 8 & n.4).[2] Moreover, the record shows that the deprivation of Constitutional due process is manifest in the actions of the courts below and inherent in Petitioners' challenges to those actions.

Respondents do not dispute that such challenges were raised, but rather seek to reformulate and recharacterize them in a failed effort to defeat this Court's jurisdiction. (Opposition at 7-8). The issues are properly before this Court for review.

2. Respondents seek to justify the Arizona Supreme Court's affirmance of the trial court's *sua sponte* grant of a directed verdict to the plaintiffs at the close of the plaintiffs' case on the ground that the Arizona Supreme Court was merely resolving a question of contract interpretation under Arizona law. (Opposition at 11).

The difficulty with this claim is that the Arizona Supreme Court found it necessary to rely upon the plaintiff's testimony as to her understanding of the policy (Petition at 10; Petition App. 12a)—testimony that the *sua sponte* directed verdict had deprived defendants of the opportunity to rebut. Respondents indirectly, but ef-

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[2] Respondents' contention (Opposition at 8, 13) that Petitioners did not timely raise this issue because such an anomalous result was clearly foreseeable prior to the Arizona Supreme Court's decision is unfathomable.

fectively, concede this reliance on testimony by trying to characterize it as "exemplify[ing]" an "only illustrative" point. (Opposition at 10). These characterizations are ungrounded in the Arizona Supreme Court's opinion; indeed, it is clear that had the Petitioners had the opportunity to put on their evidence concerning the plaintiffs' understanding, and had that evidence been convincing (as Petitioners believe it would have been), then the Arizona Supreme Court could not have affirmed on the ground it chose.[3] Thus, the Arizona Supreme Court's affirmance of the directed verdict for plaintiffs approved the denial of opportunity to the defendants to introduce evidence on the very factual point upon which the Arizona Supreme Court's opinion turned.

Therefore, the issue is whether the Arizona Supreme Court can affirm the trial court's directed verdict against the defendants on the issue of contract liability by relying upon evidence of the plaintiffs that the defendants had been denied any opportunity to rebut. The issue, then, is unmistakably one of Constitutional due process, not Arizona contract law.

3. Respondents attempt to minimize the denial of Constitutional due process arising out of the action of the Arizona Supreme Court with regard to the jury instruction on bad faith by characterizing that Court's action as merely an "approval of the bad faith instruction under Arizona law . . . ." (Opposition at 11). Respondents are in error.

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[3] In the Arizona Supreme Court, the defendants argued that a medical expense insurance policy like the one at issue is held by courts to provide a right of reimbursement only for expenses incurred during the term of the policy. The Arizona Court agreed that this "might be persuasive" if this had been an action between two insurers, but that it had no force in an action between an insurer and an ordinary person who in fact did not so understand it, citing the plaintiff Suzanne Sparks' testimony. (Petition App. 11a-12a).

The Arizona Supreme Court did "approve" the jury instruction in its initial opinion. Then, in acting on rehearing, it changed its mind and *specifically disapproved* the use of that instruction. (Petition App. 33a). At the same time, however, the Arizona Supreme Court affirmed the judgment against Petitioners based upon the very instruction it was holding to be erroneous.[4]

Petitioners' point is that it was a complete abdication of the judicial function for the Arizona Supreme Court to disapprove jury instructions but simultaneously to refuse to disturb the judgment based on those instructions. Whether any part of its holding is consistent or inconsistent with other state law, a court should dispose of a case consistently with the rule of law it announces therein. For whatever reasons, the Arizona Supreme Court did not wish to disturb the jury verdict in this case, but, we submit, it is not consistent with due process for it to disapprove the jury instructions and simultaneously to affirm the jury's verdict.

4. Similarly, the Arizona Supreme Court flatly held that the jury instruction "regarding joint and several liability in tort as to [the defendant] PST *was improper* . . . ." (Petition App. 18a) (emphasis added). Nonetheless, that Court also held that Petitioners had to

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[4] Respondents' efforts to harmonize the inexplicable and irreconcilable actions of the Arizona Supreme Court are a failure. Respondents argue that the Court's Supplemental Opinion merely indicates that the instruction "should not be used as a model" in future cases. (Opposition at 12). In fact, the Court stated unequivocally that: "We . . . *do not approve* the use of those instructions in future cases." (Petition App. 33a) (emphasis added). Respondents also assert that the Arizona Supreme Court merely found the instructions to have been "proper, even if not so perfect that future cases should use them verbatim." (Opposition at 12). As is clear from the previously cited passage from the Arizona Supreme Court's Supplemental Opinion, the instructions are not to be used ever again under any circumstances because they are not and never have been the law of Arizona.

pay the damages assessed on the basis of those erroneous instructions. It could hardly be clearer that Petitioners have been required by the Arizona Supreme Court to pay damages that that Court held at the same time to have been improperly assessed. That does not comport with due process.

Respondents misread the significance of this Court's decision in *Washington Gas Light Co. v. Lansden*, 172 U.S. 534 (1899). That case is important for two reasons. First, it holds that in circumstances like the present (which are *a fortiori*, *see* Petition at 14-15 n.10), the Court must assume that, properly instructed (*i.e.*, with PST excluded as a defendant), the jury would have returned a smaller verdict. Second, and to the contrary of Respondents' assertions, the holding in *Washington Gas Light*

> is based upon the *substantial injustice* which we think might be the result if we were to permit judgment to be entered upon the verdict as against him alone.

172 U.S. at 550 (emphasis added). Thus, it is manifest that this Court's holding was premised upon considerations of fundamental due process, and is applicable to the very similar actions of the Arizona Supreme Court in this instance.

Respondents' assertion (Opposition at 15) that the jury was not "improperly influenced" in its computation of the damage award by the erroneous inclusion of PST is both conjectural and baseless, and cannot in any event justify the Arizona Supreme Court's affirmance of lump sum punitive damages against Petitioners. Such a conclusion could only be borne out by a retrial before a properly instructed jury. In denying Petitioners such a trial and forcing them to pay damages it held should never have been assessed, the Arizona Supreme Court

contravened this Court's clear lesson in *Washington Gas Light*, and denied Petitioners due process of law.

5. In defending the Arizona Supreme Court's affirmance of the assessment of attorney's fees against Petitioners on the basis of the trial court's *in camera* review of documentary evidence that Petitioners were forbidden to see, Respondents argue that this remarkable procedure did not impinge upon Petitioners' due process rights because the trial judge was fully apprised of the evidence submitted. (Opposition at 16). This is most emphatically not the law. To satisfy due process, "[a]ll *parties* must be fully apprised of the evidence submitted or to be considered . . . ." *Interstate Commerce Commission v. Louisville & Nashville R. R. Co.*, 227 U.S. 88, 93 (1913) (emphasis added).[5]

The Respondents' claim that the trial court did not use the fee agreement as evidence as to the size of the award "but only to ensure that the award did not exceed the limit set by the statute" (Opposition at 17) is both self-contradictory and irrelevant. Even if the latter purpose is distinct from the former, the trial court still accepted the fee agreement as evidence for that purpose, and due process requires that such evidence must be revealed to all parties.[6]

In affirming a procedure which denied Petitioners—parties to the proceedings below—access to evidence, the

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[5] Respondents go to great pains to minimize the evidentiary import of the fee agreement and argue that disclosure "would have served no purpose . . . ." (Opposition at 17). This begs the question. Disclosure would have satisfied due process.

[6] The Respondents misleadingly suggest (Opposition at 17) that some claim of privilege was involved. No such claim was or could have been made in the Arizona Supreme Court, and privilege was not mentioned by that Court.

Arizona Supreme Court denied them the due process of law.[7]

Respectfully submitted,

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DATE: November 24, 1982

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[7] The fact that the document is under seal in the court file (Opposition at 17) does not excuse the Constitutional deprivation wrought by the Arizona Supreme Court. It merely underscores it. Moreover, if the document is in fact so inconsequential, there was no reason for Respondents to deny Petitioners an opportunity to inspect it.